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COMPETITIVE EQUITY IN THE FINANCIAL SERVICES INDUSTRY

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

S. 2181

TO AUTHORIZE DEPOSITORY INSTITUTION HOLDING COMPANIES TO ENGAGE IN ACTIVITIES OF A FINANCIAL NATURE, INSURANCE UNDERWRITING AND BROKERAGE, REAL ESTATE DEVELOPMENT AND BROKERAGE, AND CERTAIN SECURITIES ACTIVITIES INCLUDING DEALING IN, UNDERWRITING AND PURCHASING GOVERNMENT AND MUNICIPAL SECURITIES, SPONSORING AND MANAGING INVESTMENT COMPANIES AND UNDERWRITING THE SECURITIES THEREOF, TO PROVIDE FOR THE SAFE AND SOUND OPERATION OF DEPOSITORY INSTITUTIONS, TO AMEND THE FEDERAL RESERVE ACT, THE HOME OWNERS' LOAN ACT OF 1933, AND THE BANK SERVICE CORPORATION ACT, AND FOR OTHER PURPOSES

S. 2134

TO ESTABLISH THE PERMISSIBLE SCOPE OF POWERS FOR DEPOSITORY INSTITUTIONS AND THEIR HOLDING COMPANIES CONSISTENT WITH THEIR SAFE AND SOUND OPERATIONS, TO SIMPLIFY THE PROCEDURES FOR ENGAGING IN SUCH ACTIVITIES, AND FOR OTHER PURPOSES

PART 1

JANUARY 16, 1984—SALT LAKE CITY, UTAH

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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COMPETITIVE EQUITY IN THE FINANCIAL SERVICES INDUSTRY

PART 1

MONDAY, JANUARY 16, 1984

U.S. Senate,
Committee on Banking, Housing, and Urban Affairs,
Salt Lake City, Utah.

The committee met at 9:30 a.m., in suite B, Salt Palace Convention Center, Salt Lake City, Utah; Senator Jake Garn (chairman of the committee) presiding.

Present: Senators Garn, Gorton, and Lautenberg.

OPENING STATEMENT OF CHAIRMAN GARN

The Chairman. The committee will come to order. I'm minus a gavel so I can't rap the table, but apparently the sound system is working well.

I'm pleased to welcome all of you here today. This hearing in Salt Lake City, I understand, is the first time a full Banking Committee hearing has been held in the State of Utah.

I would take just a few minutes to give you a little bit of background on the purpose of the hearing and background on the legislation that is before the Banking Committee this year. I do have a prepared statement that I will not take the time to read, but simply ask unanimous consent that it be printed in the record as if read.

But first, before I go into that background, let me introduce, with great pleasure, two of my colleagues from the Senate Banking Committee; Senator Slade Gorton from the State of Washington, who is a distinguished representative of that State. It's been my great pleasure to have him as a member of the Banking Committee. He is a member of the Republican Party. I wanted to make sure that we had Senator Lautenberg outnumbered this morning.

I'm also pleased to have Senator Frank Lautenberg from New Jersey with us. He is a new Member of the Senate, has served just over 1 year. He has had a distinguished career in the business field in the private sector and has added a very fine perspective to the Senate Banking Committee.

I am pleased that both of them, with their busy schedules, would take the time to be with me here this morning.

[Whereupon, the opening statement of Chairman Garn is put into the record.]

OPENING STATEMENT OF SENATOR JAKE GARN

January 16, 1984

It is with pleasure that I open the first full Banking Committee hearing to be held in the State of Utah.

National issues, such as those we will be discussing today regarding our financial system, are usually discussed and decided in Washington and felt in the fifty states. As a former mayor of Salt Lake City, I believe it is important that the Washington decision-making process not always be so distant - figuratively or literally - from local jurisdictions.

While it is usually necessary for Congress to meet in one place, Committee hearings such as this provide a different perspective on the issues. It provides an opportunity for national figures such as Secretary Regan and Chairman Volcker to discuss their views in a local setting and it affords a better opportunity for local people to participate in and observe the Federal legislative process. My only regret is that we cannot hold all of our Committee hearings in Salt Lake City.

The subject of today's hearing is banking legislation designed to address the changing environment within our financial system. I introduced a bill, S. 2181, this past November to deal with powers of bank holding companies, interstate banking operations, bank acquisitions by insurance companies, securities firms and other similar financial services organizations, interest on checking accounts, and check holding policies of banks. My proposal, based principally on legislation originally drafted by the Treasury Department, also contains legislative proposals introduced separately during the past year by several Senators. Senator Proxmire of Wisconsin has introduced a bill, S. 2134, addressing many of these same issues.

The need for Congress to consider revisions to the banking statutes is evident from the changes which are occurring within the financial system. Banks are able to offer some insurance, securities, and other non-bank services but want to offer more, while insurance companies and securities firms are acquiring banks and savings and loans af fast as they can. Many of these changes were not contemplated or dreamed of by the authors of existing banking laws - most of which were enacted during the 1930's - and this has caused consumer and business confusion and competitive inequities within the system.

This Committee's job is to review these matters, determine what, if any, statutory revisions are necessary, and act on any changes deemed appropriate. The result of the process, no matter if my proposal or other legislation is enacted, will be a better defined Congressional policy toward ensuring a competitive, diverse, and strong financial system.

This process, deregulation, started a long, long time ago. A lot of people think it's something that's new, occurred last week or a year ago or a couple of years ago. But ever since I've been on the Senate Banking Committee, for the last 9 years, there have been very dramatic changes occurring in the marketplace and the financial services industry.

A lot of that change has been due to technology; electronic funds transfers give you the ability to move money not only nationally but internationally. All of you are aware of what computers have done to the industry. You see the automatic teller machines, the ATM's; you see the tremendous advances in the ability to account for money, where it goes, and how it is being used.

As a result of that technology change and the increasing sophistication of the public demanding better returns on their investment and to have a large number of alternatives of where they wish to place their savings and investment money, what were rapid changes a few years ago have turned into a revolution with innovative minds daily figuring out ways to provide new services to their customers.

Most of the laws governing the banking and investment field in this country were the result of the early 1930's after the Great Depression. Although those laws have been modified over the years, it has mostly come in minor changes to those laws.

So we have had this difficult situation of a marketplace that exists in 1984 and a lot of laws that are in the 1930's. So there has been an attempt over the last few years to try to rationalize the differences and try and make certain that the laws match what is taking place in the marketplace.

Obviously, there are a lot of differences of opinion on how those laws should be changed, if they should be changed at all.

The first attempt at this came in March 1980 when the Depository Institutions Deregulation Monetary Control Act of 1980 was passed.

The second step in that process was a bill known as Garn-St Germain, which passed in October 1982 and became Public Law 97-320, to continue that process of modernization of the financial service industry rules and regulations and laws.

And the third step is a bill, S. 2181, introduced in November of this year to continue that process.

The thing that I want to make very clear here that I have tried to over the years, that there are a lot of differences of opinion of how the changes should be made. That is the purpose of the hearing. There are a lot of people who are very frightened as soon as new legislation comes up. They overreact to that legislation and start doing everything they can to defeat it or change it in some way.

So that I don't become too lengthy in talking about the process, I would remind everyone if they are concerned at this point about this legislation which has been introduced, and this is the very first hearing to be held on it, there will be numerous hearings. I would expect before we are through, that the hearing process will probably be at least as long as it was on the previous bill, extending through most of the spring and probably in the neighborhood of 12 to 14 hearings with a massive amount of testimony from everyone who desires to testify and express their viewpoint.

The reason I would expect or ask people not to be too worried, if they would go back and look at S. 1720 which is the forerunner of Garn-St Germain, and although I made cautions at that time that there were parts of that bill that I did not necessarily agree with and that I expected that it would be changed dramatically before it became law, still the initial 2 or 3 months after the introduction of that bill were very difficult and very controversial.

Yet if someone were to look at the original draft bill of S. 1720 and compare it to Garn-St Germain you would find there were a large number of changes, very substantive changes, that occurred as a result of the hearing process.

Some of the people asked why I would place controversial provisions in the bill. Because I feel very strongly, and I think the entire Banking Committee supports me in this effort, that regardless of how controversial an issue is, it deserves to be seen in the light of day and not to be done sneakily with a last-minute amendment or attach it to the last bill on the floor or pass something that did not have hearings, has not been properly considered, and is done too hurriedly. I feel very strongly about that and the committee does, too, and that's why some of the issues, as controversial as they are, are included in the bill.

Everybody has an opportunity to express their viewpoint, has an opportunity to change and modify and produce a bill, as we did in 1982, that does have general support and consensus; and that process will be exactly the same.

We start with a draft bill and this is the first day of hearings. I have said there will be many, many more. At the end of this process I am sure that there will be a large number of changes before it finally becomes law. So I want to make certain everybody understood the process and did not get too uptight or concerned about any particular provision at this early stage of this process, which may be completed this year and may not.

It is an election year and politicians tend to try to stay away from controversial issues during election years. I hope that is not the case because the marketplace does continue to change. I would hope that we could complete this process by the summer and produce another bill that could be passed and signed into law. If not, the year will not be lost.

We will have had the opportunity to gain information from all different viewpoints. Everybody will have had the opportunity to have had their day in court and express their opinions on the legislation. That will be valuable going into 1985.

Again, a lot of people think that it's impossible to pass legislation this year. I certainly do not. I think it is possible; but if it is not, we certainly will continue the process because the marketplace is not standing still.

I do appreciate all of you being here and I especially wish to thank Chairman Volcker and Secretary Regan for being willing to come to the field hearings. They are subjected to the Banking Committee in Washington and many, many times per year. So it requires a good deal of extra effort on their part to travel out here.

[Copies of bills being considered follow:]

98TH CONGRESS
1ST SESSION

S. 2181

To authorize depository institution holding companies to engage in activities of a financial nature, insurance underwriting and brokerage, real estate development and brokerage, and certain securities activities including dealing in, underwriting and purchasing government and municipal securities, sponsoring and managing investment companies and underwriting the securities thereof, to provide for the safe and sound operation of depository institutions, to amend the Federal Reserve Act, the Home Owners' Loan Act of 1933, and the Bank Service Corporation Act, and for other purposes.

IN THE SENATE OF THE UNITED STATES

NOVEMBER 18 (legislative day, NOVEMBER 14), 1983

Mr. GARN introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To authorize depository institution holding companies to engage in activities of a financial nature, insurance underwriting and brokerage, real estate development and brokerage, and certain securities activities including dealing in, underwriting and purchasing government and municipal securities, sponsoring and managing investment companies and underwriting the securities thereof, to provide for the safe and sound operation of depository institutions, to amend the Federal Reserve Act, the Home Owners' Loan Act of 1933, and the Bank Service Corporation Act, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE OF ACT

SECTION 1. This Act may be cited as the "Financial Services Competitive Equity Act".

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TITLE I—FINANCIAL INSTITUTIONS COMPETITIVE EQUITY

AMENDMENTS TO THE BANKING ACT OF 1933

SEC. 101. (a) Section 20 of the Banking Act of 1933 (12 U.S.C. 377) is amended by inserting the following new paragraph after the first paragraph of such section:

"Notwithstanding any other provision of this section, a member bank may be affiliated in any manner described in section 2(b) with a depository institution securities affiliate as defined in section 2(j) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(j)).".

(b) Section 32 of the Banking Act of 1933 (12 U.S.C. 78) is amended by inserting the following sentence at the end of the first paragraph of such section: "Notwithstanding any other provision of this section, an officer, director, or employee of any member bank may serve at the same time as an officer, director, or employee of any of its depository institution securities affiliates. The term 'depository institution securities affiliate' shall have the meaning ascribed to it in section 2(j) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(j)).".

AMENDMENTS TO THE SECURITIES ACT OF 1933

SEC. 102. Section 4 of the Securities Act of 1933 (15 U.S.C. 77d) is amended adding at the end thereof the following:

"(7) Transactions involving offers or sales of equity securities, in connection with the acquisition of a bank by a company under the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.), or in connection with the acquisition of an insured institution by a company under the Savings and Loan Holding Company Amendments of 1967 (12 U.S.C. 1730a), if such acquisition occurs solely as part of a reorganization in which a person or group of persons exchange their shares of a bank or insured institution for shares of a newly formed bank holding company or savings and loan holding company and receive, after such reorganization, substantially the same proportional share interests in the holding company as they held in the bank or insured institution, except for changes in shareholder interests resulting from the exercise of dissenting shareholder rights under State law.".

AMENDMENTS TO THE SECURITIES EXCHANGE ACT

SEC. 103. (a) Subparagraphs (i), (ii), and (iii) of paragraph (34)(A) of subsection 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(34)(A)) are each amended by inserting immediately before the semicolons at the end thereof the following: "other than a depository institution securities affiliate as defined in section 2(j) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(j)) or as defined in section 408(a)(1)(K) of the National Housing Act (12 U.S.C. 1730a(a)(1)(K))".

(b) Section 15B(b)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–4(b)(1)) is amended by striking out "subsidiaries" in subparagraphs (B) and (C) and inserting in lieu thereof "affiliates".

AMENDMENTS TO THE BANK HOLDING COMPANY ACT

SEC. 104. (a) Section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841) is amended—

(1) by amending subsection (c) to read as follows:

"(c) 'Bank' means (1) an 'insured bank' as defined in section 3(h) of the Federal Deposit Insurance Act; or (2) any institution organized under the laws of the United States, any State of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands, that accepts deposits that the depositor may withdraw by check or similar means for payment to third parties and is engaged in the business of making commercial loans. The term 'bank' does not include (A) any foreign bank having an insured branch; (B) an insured institution; (C) any organization operating under section 25 or section 25(a) of the Federal Reserve Act; (D) any organization that does not do business in the United States except as an incident to its activities outside the United States; or (E) any consumer bank as defined in subsection (k) of this section or any industrial bank, Morris Plan bank, industrial loan company or similar institution, operated in the manner authorized by State law, that does not both engage in the business of making commercial loans and accept deposits that the depositor has a legal right to withdraw on demand."; and

(2) by inserting after subsection (i) the following new subsections:

"(j) The term 'depository institution securities affiliate' means any corporation that (1) is engaged in the United States in one or more of the activities authorized pursuant to section 4(c)(15) of this Act, and (2) is a broker or dealer within the meaning of paragraph (4) or (5) of section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)), or an investment adviser within the meaning of section 202(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(11)). For purposes of this Act, a corporation engaged in any such activities shall be deemed to be a depository institution securities affiliate only so long as it is a bank holding company or is owned or controlled by a bank holding company.

"(k) The term 'consumer bank' means any institution that would otherwise be a 'bank' under subsection (c) of this section but that does not engage in the business of making commercial loans.

"(l) the term 'commercial loans' does not include (1) loans to natural persons primarily for personal, family, or household purposes, whether directly, indirectly or through the use of leases; (2) loans for charitable persons; (3) loans secured by residential real property; (4) loans to natural persons through use of credit cards or similar means of access; or (5) investments such as commercial paper, certificates of deposit, bankers acceptances and similar money market instruments, the extension of broker call loans, the sale of Federal funds, the deposit of interest-bearing funds, mortgage-backed securities, obligations of the United States and local and State governments, or agencies and instrumentalities thereof, and such other similar types of investments as may be permitted by the institution's primary regulator. An institution shall not be deemed to 'engage in the business of making commercial loans' if the aggregate principal amount of its outstanding commercial loans represented by (A) credit to finance the inventorying of goods generally being acquired by natural persons; (B) loans to small business concerns; and (C) similar loans, does not exceed 5 percent of the institution's total assets.

"(m) For purposes of this Act—

"(1) the term 'depository institution holding company' means a bank holding company;

"(2) the term 'depository institution' means bank; and

"(3) the terms 'savings and loan holding company' and 'insured institution' have the meanings ascribed to them in section 408(a)(1) of the National Housing Act.".

(b) Section 3 of the Bank Holding Company Act of 1956 (12 U.S.C. 1842) is amended—

(1) by inserting before the period at the end of the second sentence of subsection (a) the following: "; or (C) with thirty days prior notification to the Board, the acquisition by a company of control of a bank in a reorganization in which a person or group of persons exchange their shares of the bank for shares of a newly formed bank holding company and receive, after such reorganization, substantially the same proportional share interest in the holding company as they held in the bank except for changes in shareholder interests resulting from the exercise of dissenting shareholder rights under State law if, immediately following such acquisition, the bank holding company meets the capital and other financial standards prescribed by the Board by regulation for such a bank holding company and the holding company does not engage in any activities other than those of banking or managing and controlling banks. In promulgating regulations pursuant to this subsection, the Board shall not require more capi-

tal for the subsidiary bank immediately following the reorganization that is required for a similarly sized bank that is not a subsidiary of a bank holding company."; and

(2) by adding at the end thereof the following:

"(f) No company may acquire, directly or indirectly, any voting shares of, interest in, or substantially all of the assets of any additional consumer bank located outside of the State in which the operations of such company's consumer bank subsidiaries were principally conducted on July 1, 1983, unless—

"(1) the acquisition of such shares or assets of a consumer bank in such State by a company controlling a consumer bank in another State is specifically authorized by the statute laws of the State in which such consumer bank is located, by language to that effect and not merely by implication;

"(2) the acquisition of shares or assets of a bank in such State by a bank holding company is specifically authorized by the statute laws of the State in which such bank is located, by language to that effect and not merely by implication; or

"(3) the acquisition of such shares or assets of an industrial bank, Morris Plan bank, industrial loan company, or similar institution by a company is authorized by the statute laws of the State in which such institution is located, by language to that effect and not merely by implication.

For the purpose of this section, the State in which the operations of a company's consumer bank subsidiaries are principally conducted is that State in which total deposits of all such consumer bank subsidiaries are largest.".

(c) Section 4(a)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(a)(2)) is amended—

(1) by striking out subparagraph (B) and inserting in lieu thereof the following: "(B) those permitted under paragraphs (8) (except for those of an insured institution), (15), and (16) of subsection (c) of this section subject to all the conditions and requirements specified in each respective paragraph or in any order or regulation issued by the Board under such paragraphs"; and

(2) by adding at the end thereof the following: "The two-year period referred to in this paragraph shall not apply to a company that becomes a bank holding company as a result of enactment of the Financial Services Competitive Equity Act and that acquired a bank between July 1, 1983, and the effective date of such Act. A company that becomes a bank holding company as a result of the enactment of the Financial Services Competitive Equity Act, and that controlled

an insured bank on July 1, 1983, may engage in any activity in which it was lawfully engaged, directly or through a subsidiary, on July 1, 1983, and in which it has been engaged continuously since July 1, 1983. The authority conferred by the preceding sentence (i) shall terminate at such time as (I) any covered bank holding company acquires control of an additional bank or an insured institution, (II) its existing subsidiary bank commences accepting deposits that the depositor has a legal right to withdraw on demand and engages in the business of making commercial loans, or (III) any covered bank holding company commences, directly or through a subsidiary, after July 1, 1983, any additional activities, other than those activities authorized pursuant to this act (except for the acquisition of an insured institution), in which it was not engaged on July 1, 1983; and (ii) may be terminated by the Board by order, after opportunity for hearing, if it determines, having due regard to the purposes of this chapter, that such action is necessary to prevent conflicts of interests or unsound banking practices or is in the public interest. Any activities authorized for bank holding companies may not be expanded and any additional activities may not be commenced except in accordance with the requirements, conditions, and limitations applicable to bank holding companies.".

(d) Paragraph 8 of subsection 4(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 843(c)) is amended to read as follows:

"(8)(A) in accordance with the limitations and requirements contained in subparagraphs (B) and (C) of this paragraph, shares of any insured institution, shares of a consumer bank, or shares of any company the activities of which consist of—

"(i) activities that the Board has determined (by order or regulation) to be closely related to banking or managing or controlling banks or (by regulation) to be of a financial nature;

"(ii) insurance underwriting or brokerage; or

"(iii) real estate investment, development or brokerage: *Provided,* That, in the case of real estate investment and development, the percentage of a bank holding company's capital that may be devoted to this activity shall not exceed 5 per centum of such company's primary capital, except that for purposes of this clause, real estate investment and development shall include, but not be limited to, the acquisition, management, and maintenance of developed or undeveloped real estate, but shall not include any form of construction activity.

"(B)(i) No bank holding company shall engage in any activity authorized under this paragraph either de novo or by an acquisition in whole or in part of a going concern, unless the Board has been given sixty days prior written notice of such proposal and, within such period, the Board has not issued an order (I) disapproving the proposal, or (II) suspending the time period in accordance with clause (iii) below.

"(ii) An acquisition may be made prior to the expiration of the disapproval period if the Board issues a written notice of its intent not to disapprove the action. The Board may provide for no notice under this paragraph or notice for a shorter period of time with respect to particular activities. No notice under this paragraph is required in the event a bank holding company establishes de novo an office to engage in any activity previously authorized for such a bank holding company under this paragraph or changes the location of an office engaged in such activity.

"(iii) The notice submitted to the Board shall contain such information as the Board shall prescribe by regulation or by specific request in connection with a particular notice: *Provided, however,* That the Board may only require such information as may be relevant to the nature and scope of the proposed activity and to the Board's evaluation of the criteria provided for in clause (iv) hereof. In the event the Board requires additional relevant information beyond that provided in the notice submitted pursuant to this paragraph, the Board may by order suspend the time period provided in clause (i) hereof until it has received such additional relevant information, and the activity that is the subject of the notice may be commenced within thirty days of the date of such receipt unless the Board issues a disapproval order as provided in clause (i) hereof. Such a suspension order is reviewable under section 9 of this Act.

"(iv) In connection with a notice under this paragraph, the Board may consider the following criteria—

"(I) the managerial resources of the companies involved;

"(II) the adequacy of their financial resources, including their capital, giving consideration to the financial resources and capital of others engaged in similar activities: *Provided*, That the Board shall not require a higher level of capital for any activity subject to Federal or State regulation than would be required by the applicable regulatory authority for a company engaged in such activity, unless the Board shall find that particular circumstances warrant a higher level of capital;

"(III) any practice or arrangement that may adversely affect the independence or impartiality of an affiliated bank in the provision of credit or other services or the terms on which such credit and services are made available, or the availability of such credit;

"(IV) any material adverse effect on the safety and soundness or financial condition of an affiliated bank or banks; and

"(V) with respect to an acquisition subject to subparagraph (i) or (ii) of paragraph (8)(c), compliance with such subparagraph.

"(v) The Board shall by order set forth the reasons for any disapproval under this paragraph. Inaction on any notice or a Board order determining not to disapprove a proposal to engage in an activity that has previously been authorized by regulation under this paragraph shall be final and shall not be subject to judicial review under this Act or in any other manner: *Provided, however,* That any bank holding company may obtain judicial review pursuant to section 9 of this

Act of any Board order not to disapprove a notice under this paragraph if such order contains restrictions or conditions.

"(vi) The Board shall, within one hundred and eighty days of enactment of the Financial Services Competitive Equity Act and from time to time thereafter, promulgate regulations under this paragraph designating particular activities that are closely related to banking or of a financial nature. A bank holding company may petition the Board to determine by regulation that a particular activity is closely related to banking or of a financial nature. The Board may by regulation prescribe limitations on the conduct of any activity or activities authorized under paragraphs (8), (15), and (16) of this subsection consistent with the criteria in subparagraph (B)(iv) hereof and with safe and sound financial practices. In administering this paragraph, the Board shall promote competition between bank holding companies and all other companies engaged in activities of a financial nature or closely related to banking.

"(vii) The regulation required under clause (vi) of this paragraph shall include any activity determined by the Board by regulation prior to enactment of this Act to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. The

Board shall not designate as an activity of a financial nature or closely related to banking within the meaning of this paragraph any activity that is described in paragraph (15) of this subsection or that is prohibited to a member bank or an affiliate of a member bank under sections 16 (12 U.S.C. 24 (Seventh)) or 20 (12 U.S.C. 377) of the Banking Act of 1933.

"(C)(i) No bank holding company that owns or controls one or more banks with consolidated deposits in the United States equal to or exceeding 0.30 per centum of all domestic deposits in the United States shall acquire, merge, or consolidate with, or purchase the assets of, a company engaged in insurance, securities, real estate or other activities permissible under paragraph (8) or (15) of this section hereof if, immediately after and as a result of such acquisition, such bank holding company shall have an investment in any one such activity that exceeds 25 per centum of the consolidated capital of such bank holding company.

"(ii) No company that is engaged in an activity otherwise permissible for bank holding companies under paragraph (8) or (15) of this section shall acquire, merge, or consolidate with, or purchase the assets of, a bank or banks with consolidated deposits in the United States equal to or exceeding 0.30 per centum of all domestic deposits in the United States, if, immediately after and as a result of such acquisition, such company shall have an investment in any one such activity that exceeds 25 per centum of the consolidated capital of such company.

"(D)(i) Notwithstanding any other provision of this paragraph, an acquisition involving direct or indirect control of an insured institution by a bank holding company (except an acquisition resulting from a transaction authorized under section 13(f) of the Federal Deposit Insurance Act or section 408(m) of the National Housing Act) shall be subject to the restrictions of section 3(d) hereof, as if the insured institution were a bank.

"(ii) Except for a branch or branches resulting from an acquisition under section 408(m) of the National Housing Act, any insured institution that becomes a subsidiary of a bank holding company may retain and operate its existing branch or branches, but otherwise its branches shall be subject to locations where a national bank may establish and operate branches in the State in which such insured branch is located.".

(e) Section 4(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)) is amended—

(1) by striking out the penultimate sentence thereof;

(2) by striking out the period at the end thereof and inserting in lieu thereof a semicolon; and

(3) by adding at the end thereof the following:

"(15) shares of any depository institution securities affiliate engaged in activities in accordance with the limitations contained in this paragraph:

"(i) No depository institution holding company that establishes or acquires any depository institution securities affiliate pursuant to this paragraph shall, after one year from the date on which any such depository institution securities affiliate first engages in any of the activities authorized under subparagraph (iii) of this paragraph, permit any depository institution contolled by such depository institution holding company to engage, directly or through a subsidiary, in the United States in any of the activities authorized under such subparagraph (iii) of this paragraph or any of the following activities, which are authorized pursuant to paragraph Seventh of section 5136 of the Revised Statutes of the United States, as amended (12 U.S.C. 24): dealing in and underwriting obligations of the United States, general obligations of any State of the United States or any political subdivision thereof and other obligations listed in paragraph Seventh of such section 5136 and purchasing and selling securities and stock as agent. For purposes of this paragraph, the Board may, by regulation or order, determine other securities or securities-related activities in which depository institutions may not engage. No rule, regulation or order of the Board, however, shall prohibit a depository institution from engaging in those securities or securities-related activities that are necessary or incidental to the financing of such depository institution or the investment of its funds. In the event that a depository institution holding company terminates all of the activities specified in subparagraph (iii) of this paragraph of its depository institution securities affiliate, any depository institution subsidiary of such holding company may conduct, directly or through a subsidiary, any securities or securities-related activities that it is authorized by law to conduct.

"(ii) Any depository institution securities affiliate may conduct any securities or securities-related activity that a national banking association, as such term is used in section 21 of this title, is not prohibited from conducting.

"(iii) In addition to the activities referred to in subparagraphs (i) and (ii) of this paragraph, such depository institution securities affiliate may—

"(I) deal in and underwrite all obligations issued or guaranteed by or on behalf of a State or any political subdivision thereof or any agency or instrumentality of either of the foregoing, except industrial development bonds as defined in section 103(b)(2) of the Internal Revenue Code of 1954, as amended: *Provided, however,* That depository institution securities affiliates may deal in and underwrite such industrial development bonds, the interest on which is exempt from Federal income tax under section 103(a) of the Internal Revenue Code of 1954, as amended, if: (i) a State, territory, possession of the United States, or any political subdivision of the foregoing, or the District of Columbia pledges its full faith and credit for the payment of all principal and interest on such bonds or (ii) the issuer, or the State or local governmental unit on behalf of which the industrial development bonds were issued, is considered the sole owner, for Federal income tax purposes, of the facility with respect to which financing is to be provided from the proceeds of such industrial development bonds;

"(II) organize, sponsor, operate, and control an investment company, as such term is defined in section 3 of the Investment Company Act of 1940, as amended;

"(III) render investment advice to: (1) an investment company as described in subparagraph (B) above; and any investment company other than a closed-end investment company;

"(IV) underwrite, distribute, and sell securities of any investment company, as such terms are defined in section 3 of the Investment Company Act of 1940; and

"(V) deal in and underwrite promissory notes secured by real estate mortgages and participation interests in such notes or mortgage related payment bonds secured by such notes or participation interests. For purposes of this subparagraph, a mortgage related payment bond means an obligation (which may be with or without recourse to the issuer thereof) which, by its terms, provides for payments of principal in relation to payments, or reasonable projections of payments, on notes meeting the above requirements or participation interests therein which are pledged as security for such obligation and which are rated in one of the four highest rating categories by at least one nationally recognized statistical rating organization.

"(iv) A bank holding company seeking to acquire shares of a depository institution securities affiliate or engage directly in securities or securities-related activities pursuant to this paragraph shall comply with the notice and other requirements of clauses (i) through (vi) of paragraph (8)(B) of this subsection; or".

(f) Section 4(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)) is amended by adding at the end thereof the following:

"(16) shares of any company engaged in any activity in which a multiple savings and loan holding company was authorized by law or regulation to engage directly on July 1, 1983: *Provided, however,* That the activities of real estate investment and development may only be engaged in within the limitations of clause (iii) of section 4(c)(8)(A) of this Act: *And provided further,* That any conditions and limitations applicable to a savings and loan company with respect to such activities shall likewise be applicable to such a bank holding company, except that a bank holding company seeking to acquire shares of such a company pursuant to this paragraph shall comply with the notice and other requirements of clauses (i) through (vi) of paragraph (8)(B) of this subsection and except that the Board may by regulation prohibit any bank holding company from engaging in such activities or limit their conduct.".

(g) Section 5(c) of the Bank Holding Company Act (12 U.S.C. 1844(c)) is amended to read as follows:

"(c)(1) The Board from time to time may require reports under oath, in such scope and detail as it may determine, of a bank holding company and each subsidiary thereof to keep the Board informed as to whether such companies are complying with the provisions of this chapter and regulations and orders issued thereunder.

"(2) Except where the Board determines that a lesser reporting requirement is appropriate, the Board shall accept in fulfillment of the reporting requirements established by this subsection for nonbank subsidiaries separate reports consisting of (A) for companies subject to the reporting requirements of section 17 of the Securities Exchange Act of 1934 (15 U.S.C. 78q), the same information required to be submitted to the Securities and Exchange Commission under such section (and the rules and regulations thereunder) at the same time such information is so submitted; and (B) for all other companies, the same information as would be required to be submitted under section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) (and the rules and regulations thereunder) by companies subject to the reporting requirements of such Act, that are engaged in the same or similar lines of business, not more frequently than quarterly. In particular circumstances, the Board may require additional information in order to fulfill its responsibilities under this Act.

"(3) The Board may make examinations of each bank holding company and each subsidiary thereof, the cost of which may be assessed against, and paid by, such holding company. The Board shall, however, insofar as possible, minimize the scope and frequency of examinations of nonbank subsidiaries of a bank holding company by utilizing, where feasible, reports of applicable regulatory agencies or other bodies public or private, and by directing, to the extent feasible, the focus of such examinations to the activities or financial condition of such nonbank subsidiaries that may have a materially adverse effect on the safety and soundness or financial condition of a subsidiary bank of the bank holding company.".

(h) Section 7 of the Bank Holding Company Act of 1956 (12 U.S.C. 1846) is amended by striking out the period at the end thereof and inserting in lieu thereof ", except that (1) no State may prohibit the affiliation of a national banking association, as such term is used in section 21 of this title, with a company engaged only in one or more of the activities described in paragraphs (8), (15), and (16) of subsection 4(c) of this Act, and (2) no State may authorize banks which it charters to engage in insurance activities outside such State on a basis different from that authorized for such banks within the State.".

AMENDMENT TO THE FEDERAL RESERVE ACT

SEC. 105. (a) The Federal Reserve Act is amended by inserting after section 23A the following:

SEC. 23B. RESTRICTIONS ON TRANSACTIONS WITH AFFILIATES.—(a) A member bank and its subsidiaries may engage in any of the following transactions, only on terms and under circumstances, including credit standards, that are substantially the same as, or at least as favorable to such bank or its subsidiary as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies or, in the absence of comparable transactions, those terms and circumstances that in good faith would be offered to, or would apply to nonaffiliated companies—

"(1) any covered transaction, as defined in section 23A, with an affiliate;

"(2) the sale of securities or other assets, including assets subject to an agreement to repurchase, to an affiliate;

"(3) the payment of money or the furnishing of services to an affiliate, under contract, a lease, or otherwise;

"(4) any transaction in which an affiliate acts as an agent or broker or receives a fee for its services to the bank or any other person; or

"(5) any transaction or series of transactions with a third party, (A) if an affiliate has a financial interest in the third party, or (B) if an affiliate is a participant in such transaction or series of transactions.

For the purposes of this subsection, any transaction by a member bank with any person shall be deemed to be a transaction with an affiliate of such bank to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, such affiliate.

"(b) A member bank and the affiliates of such bank shall not publish any advertisement or enter into any agreement stating or suggesting that the bank shall in any way be responsible for the obligations of its affiliates; however, a member bank and its affiliates may use similar names.

"(c) A member bank and any subsidiary of such bank—

"(1) shall not purchase as fiduciary any securities or other assets from any affiliate unless such purchases are permitted under the instrument creating the fiduciary relationship, by court order, or by law of the jurisdiction under which the trust is administered; and

"(2) whether acting as principal or fiduciary, shall not knowingly purchase or otherwise acquire, during the existence of any underwriting or selling syndicate, any security a principal underwriter of which is an affiliate of such bank; except that this prohibition shall not apply where the purchase of such securities has been approved, prior to the time at which such securities are initially offered for sale to the public, by a majority of the directors of the bank who are not officers or employees of the bank or any affiliate thereof.

For the purpose of this paragraph, the term 'security' means a 'security' as defined in section 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(12)); and the term 'principal underwriter' means any underwriter who, in connection with a primary distribution of securities, (A) is in privity of contract with the issuer or an affiliated person of the issuer; (B) acting alone or in concert with one or more persons, initiates or directs the formation of an underwriting syndicate; or (C) is allowed a rate of gross commission, spread, or other profit greater than the rate allowed another underwriter participating in the distribution.

"(d) For the purpose of this section—

"(1) the term 'affiliate' means an 'affiliate' as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371C) excluding a bank; and

"(2) the terms 'bank', 'subsidiary', 'person', and 'security' (other than security as used in subsection (c)) have the same meaning given to them in section 23A of the Federal Reserve Act (12 U.S.C. 371c).".

"(e) The Board may prescribe rules and regulations to administer and carry out the purposes of this section, including rules or regulations to (1) further define terms used in this section; (2) exempt transactions or relationships from the requirements of this section; or (3) exclude from the definition of 'affiliate' in this section any subsidiary of a bank holding company, if the Board finds such exemptions or exclusions to be in the public interest and consistent with purposes of this section.".

(b) Section 18(j) of the Federal Deposit Insurance Act (12 U.S.C. 1828(j) is hereby amended—

(1) by inserting "and section 23B" after "section 23A" at each place it appears in paragraph (1); and

(2) by inserting ", 23B," after "23A" in paragraph (3)(A).

AMENDMENTS TO THE INVESTMENT COMPANY ACT OF 1940

SEC. 106. (a) Section 17(f) of the Investment Company Act of 1940 (15 U.S.C. 80a–17(f)) is amended by inserting after "unit investment trusts" the following: ": *Provided, however*, That any registered management company which is organized, sponsored, operated, or controlled by, or which receives investment advice from, any depository institution securities affiliate, as defined in section 2(j) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(j)) or in section 408(a)(1)(K) of the National Housing Act (12 U.S.C. 1730a(a)(1)(K)), may place and maintain its securities and similar investments in the custody of a bank which is affiliated with such depository institution securities affiliate only with the prior approval of the Commission".

(b) Section 26(a)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a–26(a)(1)) is amended by inserting after "so published);" the following: ": *Provided, however*, That, except with the prior approval of the Commission, it shall be unlawful for such trust indenture, agreement of custodianship, or other instrument to designate as trustee or custodian any bank which is affiliated with a depository institution securities affiliate, as defined in the Bank Holding Company

Act of 1956 (12 U.S.C. 1841(j)) or in section 408(a)(1)(K) of the National Housing Act (12 U.S.C. 1730a(a)(1)(K)), which organizes, sponsors, operates or controls such registered unit investment trust".

(c) Section 27(c)(2) of the Investment Company Act of 1940 (15 U.S.C. 80–27(c)(2)) is amended by inserting after "trust indentures of unit investment trusts" the following: ": *Provided, however,* That, except with the prior approval of the Commission, it shall be unlawful to deposit such proceeds with any bank which is affiliated with a depository institution securities affiliate, as defined in section 2(j) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(j)) or in section 408(a)(1)(K) of the National Housing Act (12 U.S.C. 1730a(a)(1)(K)), which organizes, sponsors, operates, controls or renders investment advice to such registered investment company".

AMENDMENTS TO BANK HOLDING COMPANY ACT AMENDMENTS OF 1970

SEC. 107. Section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971 et seq.) is amended—

(1) by redesignating subsections (c) through (h) as subsections (d) through (i), respectively; and

(2) by inserting after subsection (b) the following:

"(c) A bank shall—

"(1) explain in writing to a person who solicits credit with reference to which insurance is or may be required that such insurance may be purchased from an insurer or agent of such person's choice, and shall not directly or indirectly solicit such insurance until it has given such person a commitment in writing that the credit solicited shall be extended;

"(2) not unreasonably reject a contract of insurance furnished by a borrower for the protection of the property securing the credit or lien, and shall not reject such a contract without giving the borrower a statement in writing stating the reasons therefor, nor shall it require that any borrower, mortgagor, purchaser, insurer, broker, or agent pay a separate charge in connection with the handling of any contract of insurance required as security for a loan, or pay a separate charge to substitute the insurance policy of one insurer for that of another, nor shall it require any procedures or conditions of duly licensed agents, brokers, or insurers not customarily required of those agents, brokers, or insurers affiliated or in any way connected with the bank;

"(3) not use or disclose, without the prior written consent of the borrower, mortgagor, or purchaser obtained at a time other than the making of the loan or extension of credit, information relative to a contract of insurance which is required by the credit transaction, for the purpose of replacing such insurance;

"(4)(A) accept, with regard to any insurance issued or sold by it or an affiliate thereof, in connection with an extension of credit made by such bank, the cancellation by a borrower of any such insurance if notified by the borrower within 30 days of the effective date of the insurance; and

"(B) refund the unearned portion of the premium to the creditor within twenty days after receipt of a notice of cancellation if no liability for a loss under the insurance has been incurred."; and

(3) by adding at the end of subsection (b)(2) the following:

"(I) Any action for injunctive relief that may be commenced by any person pursuant to subsection (g) may be commenced on behalf of such person by any trade association of which such person is a member. Any such action commenced by a trade association shall be subject to the same requirements, limitations, and conditions as would be applicable had such action been commenced by any such person pursuant to subsection (g).".

AMENDMENTS TO THE NATIONAL HOUSING ACT

SEC. 108. (a) Section 408(a)(1) of the National Housing Act (12 U.S.C. 1730a(a)(1)) is amended—

(1) by amending subparagraph (A) to read as follows:

"(A) 'insured institution' means a Federal savings and loan association, a Federal savings bank, a building and loan, savings and loan or homestead association, or a cooperative bank, the accounts of which are insured by the Federal Savings and Loan Insurance Corporation, and shall include a Federal savings bank or a stock savings bank, the deposits of which are insured by the Federal Deposit Insurance Corporation;";

(2) by amending subparagraph (B) to read as follows:

"(B) 'uninsured institution' means any association or bank referred to in subparagraph (A), the accounts of which are not insured by the Federal Savings and Loan Insurance Corporation, except for a Federal savings bank or stock savings bank, the deposits of which are insured by the Federal Deposit Insurance Corporation; and"; and

(3) by adding at the end thereof the following:

"(K) 'depository institution securities affiliate' means any corporation that (i) is engaged in the United

States in one or more of the activities authorized for depository institution securities affiliates pursuant to section 4(c)(15) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)(15)) and subject to the limitations specified therein, and (ii) is a broker or dealer within the meaning of paragraph (4) or (5) of section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)), or an investment adviser within the meaning of section 202(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(11)). For purposes of this title, a corporation engaged in any such activities shall be deemed to be a depository institution securities affiliate only so long as it is owned or controlled by a savings and loan holding company. For purposes of applying section 4(c)(15) of the Bank Holding Company Act to this title—

"(i) the term 'depository institution holding company' means savings and loan holding company; and

"(ii) the term 'depository institution' means 'insured institution'.

"(L) 'bank holding company' and 'bank' shall have the meanings ascribed to them in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).".

(b) Section 408(c) of the National Housing Act (12 U.S.C. 1730a(c)) is amended to read as follows:

"(c)(1) Except as otherwise provided in this subsection, no savings and loan holding company (except a unitary savings and loan holding company that acquires an insured institution pursuant to subsection (m) of this section) or subsidiary thereof which is not an insured institution shall—

"(A) for or on behalf of such subsidiary insured institution, engage in any activity or render any service for the purposes or with the effect of evading law or regulation applicable to such insured institution; or

"(B) commence or continue, after two years from the date as of which it becomes a savings and loan holding company, any business activity other than those specified in paragraph (2) of this subsection except that such two-year period shall not apply to any company that acquires an insured institution between July 1, 1983, and the effective date of the Financial Services Competitive Equity Act: *Provided,* That any company that becomes subject, as a result of the Financial Services Competitive Equity Act, to the prohibitions of this subparagraph and that controlled an insured institution prior to July 1, 1983, may engage in any activity in which it was lawfully engaged, directly or through a subsidiary, on July 1, 1983, and in which it has been engaged continuously since July 1, 1983: *Provided,* That any activities authorized for savings and loan holding companies may not be expanded and any additional activities may not be commenced except in accordance with the requirements, conditions, and limitations applicable to savings and loan holding companies. The authority conferred by the preceding proviso, (A) shall terminate at such time as any covered savings and loan holding company (i) acquires a bank, or its subsidiary insured institution fails to qualify as a domestic building and loan association under section 7701(a)(19) of the Internal Revenue Code of 1954, or (ii) commences, directly or through a subsidiary, after July 1, 1983, any additional activities, other than those authorized pursuant to this Act to be permissible for savings and loan holding companies (except for the acquisition of a bank), in which it was not engaged on July 1, 1983, or (B) may be terminated by the Corporation, after opportunity for hearing, if it determines, having due regard for the purposes of this chapter, that such action is necessary to prevent conflicts of interests, unsound practices, or in the public interest.

"(2) The prohibitions of subparagraph (1)(B) of this subsection shall not apply to the following business activities—

"(A) furnishing or performing management services for a subsidiary insured institution;

"(B) conducting an insurance agency or escrow business;

"(C) holding or managing or liquidating assets owned or acquired from a subsidiary insured institution;

"(D) holding or managing properties used or occupied by a subsidiary insured institution;

"(E) acting as trustee under deed of trust;

"(F) acquiring shares of any bank and engaging in one or more of the following activities subject to the limitations, conditions, and requirements specified in paragraph (3) of this subsection: (i) activities determined by the Board of Governors of the Federal Reserve System (by regulation) to be of a financial nature or closely related to banking or managing or controlling banks: *Provided, however,* That the Corporation may (by regulation) prohibit or limit any such activity for savings and loan holding companies; (ii) activities in which multiple savings and loan holding companies were authorized (by regulation) to engage directly on July 1, 1983: *Provided, however,* That in the case of real estate investment and development, savings and loan holding companies may only maintain investments lawfully held on July 1, 1983, and make additional investments within the limitations of clause (iv) hereof; (iii) engaging in either or both the activities of insurance underwriting and brokerage; (iv) engaging in one or more of the activities of real estate investment, development, or brokerage: *Provided,* That, in the case of real estate investment and development, the percentage of a savings and loan holding company's capital that may be devoted to this activity shall not exceed 5 per centum of such company's primary capital, except that for purposes of this clause, real estate investment and development shall include, but not be limited to acquisition, management, and maintenance of developed or undeveloped real estate, but shall not include any form of construction activity; and (v) engaging in the activities of a depository institution securities affiliate in accordance with the terms under which such activity may be conducted pursuant to the provisions of paragraph (15) of section 4(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)), except that notwithstanding any other provision of this subparagraph, an acquisition involving the direct or indirect control of a bank by a savings and loan holding company (except an acquisition resulting from a transaction authorized under section 13(f) of the Federal Deposit Insurance Act) shall be subject to the restrictions of section 3(d) of the Bank Holding Company Act of 1956, as if any insured institution subsidiary of the savings and loan holding company were a bank and as if the savings and loan holding company were a bank holding company; and

"(G) acquiring shares of any company which is an export trading company, as that term is defined in paragraph (14) of section 4(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)), and subject to all the requirements, conditions, and limitations of such paragraph (14) as if the acquiring or establishing savings and loan holding company were a bank holding company within the meaning of that paragraph, except that any notice required to be given pursuant to that paragraph shall be given to the Corporation, which shall have the same authority with respect to such notice procedure for savings and loan holding companies as the Board of Governors of the Federal Reserve System has pursuant to such paragraph (14).

"(3)(A) No savings and loan holding company shall engage, either de novo or by an acquisition, in whole or in part, of a going concern, in any activity authorized under paragraph (2)(F) of this subsection unless the Corporation has been given sixty days' prior written notice of such proposal and, within such period, the Corporation has not issued an order disapproving the proposal or extending for up to an additional thirty days the period within which such a disapproval may be issued.

"(B) An acquisition may be made prior to the expiration of the disapproval period if the Corporation issues a written notice of its intent not to disapprove the action. The Corporation may provide for no notice under this paragraph or notice for a shorter period of time with respect to particular activities. No notice under this paragraph is required in the event a savings and loan holding company establishes de novo an office to engage in any activity previously authorized for such savings and loan holding company under this paragraph or changes the location of an office engaged in such activity.

"(C) The notice submitted to the Corporation shall contain such information as the Corporation shall prescribe by regulation for the notice or by specific request in connection with a particular notice: *Provided, however,* That the Corporation may only require such information as may be relevant to the nature and scope of the proposed activity and to the Corporation's evaluation of the criteria provided for in subparagraph (D) hereof. In the event the Corporation requires additional relevant information beyond that provided in the notice submitted pursuant to this paragraph, the Corporation may by order suspend the time period provided in subparagraph (A) of this paragraph until it has received such additional relevant information, and the activity that is the subject of the notice may be commenced within thirty days of the date of such receipt unless the Corporation issues a disapproval order as provided in such subparagraph (A). Such suspension order is reviewable under subsection (k) of this section.

"(D) In connection with a notice under this paragraph, the Corporation may consider the following criteria—

"(i) the managerial resources of the companies involved;

"(ii) the adequacy of their financial resources, including their capital, giving consideration to the financial resources and capital of others engaged in similar activities: *Provided*, That the Corporation shall not require a higher level of capital for any activity subject to Federal or State regulation than would be required by an applicable regulatory authority for a company engaged in such activity, unless the Corporation shall find that particular circumstances warrant a higher level of capital;

"(iii) any practice or arrangement that may adversely affect the independence or impartiality of an affiliated insured institution in the provision of credit or other services or the terms on which such credit and services are made available, or the availability of such credit;

"(iv) any material adverse effect on the safety and soundness or financial condition of an affiliated insured institution; and

"(v) with respect to an acquisition subject to paragraph (2) (F) or (G), compliance with such paragraph.

"(E) The Corporation shall by order set forth the reasons for any disapproval under this paragraph. Inaction on any notice or a Corporation order determining not to disapprove a proposal to engage in an activity that has previously been authorized by regulation under this paragraph shall be final and shall not be subject to judicial review under this section or in any other manner: *Provided, however,* That any savings and loan holding company may obtain judicial review pursuant to this section of any Corporation order not to disapprove a notice under this paragraph if such order contains restrictions or conditions.

"(F) The Corporation may by regulation prescribe limitations on the conduct of any activity or activities authorized under paragraph (2)(F) of this subsection other than limitations on activities conducted pursuant to clause (v) thereof, consistent with the criteria in subparagraph (D) hereof and with safe and sound financial practices.

"(G)(i) No savings and loan holding company that owns or controls an insured institution or insured institutions with consolidated deposits in the United States equal to or exceeding 0.30 per centum of all domestic deposits in the United States shall acquire, merge, or consolidate with, or purchase the assets of, a company engaged in insurance, securities, real estate or other activities permissible under paragraph (2)(F) of this paragraph, if immediately after and as a result of such acquisition, such savings and loan holding company shall have an investment in any one such activity that exceeds 25 per centum of the consolidated capital of such savings and loan holding company.

"(ii) No company that is engaged in any activity otherwise permissible for savings and loan holding companies under paragraph (2)(F) of this paragraph shall acquire, merge, or consolidate with, or purchase the assets of, a bank or banks with consolidated deposits in the United States equal to or exceeding 0.30 per centum of all domestic deposits in the United States if, immediately after and as a result of such acquisition, such company shall have an investment in any one such activity that exceeds 25 per centum of the consolidated capital of such company.

"(4)(A) Notwithstanding any other provision of this subsection, any savings and loan holding company (including any subsidiary thereof which is not an insured institution) the sole insured institution subsidiary of which is a qualified thrift lender shall not be subject to the limitations and prohibitions of this subsection: *Provided, however,* That nothing in this paragraph shall exempt a bank holding company or its subsidiaries or affiliates from the provisions of the Bank Holding Company Act.

"(B) A qualified thrift lender is any insured institution that, as determined by the Corporation—

"(i) has an aggregate of not more than 25 per centum of its assets (including loans made by any subsidiary of such institution) invested in commercial loans, nonresidential real estate loans, tangible personal property leased for commercial purposes, and floorplanning or inventory loans, and does not thereafter exceed such percentage on an average basis in three out of every four quarters and two out of every three years; or

"(ii) has an aggregate of not less than 60 per centum of its assets (including investments made by any subsidiary of such an institution) invested in loans, equity positions or securities related to domestic residential real estate or manufactured housing and property used by an institution in the conduct of its business, and does not thereafter fall below such percentage on an average basis in three out of every four quarters and two out of every three years.

"(C) Any insured institution that fails to maintain its status as a qualified thrift lender, as determined by the Corporation, may not thereafter be a qualified thrift lender for a period of 5 years. For good cause shown, the Corporation may allow any company that controls such an institution, up to three years to comply with the investment and activities restrictions contained in this subsection.

"(D) The Corporation may issue such rules or regulations, and conduct such examinations, as it determines to be necessary to carry out the provisions of this paragraph, and may enforce with respect to any qualified thrift lender: *Provided,* That with respect to a stock savings bank insured by the Federal Deposit Insurance Corporation, the Corporation shall rely to the maximum extent possible on examinations conducted by that agency.".

(c) Section 408(d) of the National Housing Act (12 U.S.C. 1730a(d)) is hereby amended as follows:

(1) The introductory phrase is amended to read as follows:

"(d)(1) Except as otherwise provided in this section, no subsidiary insured institution of a savings and loan holding company shall—";

(2) Numbers (1), (2), (3), (4), (5), and (6) shall be redesignated as (A), (B), (C), (D), (E), and (F), respectively, and letters (A), (B), and (C) shall be redesignated as (i), (ii), and (iii); and

(3) The following subsection (d)(2) shall be added at the end thereof:

"(2) The prohibitions of subsection (d)(1) shall not apply to the transactions of any subsidiary insured institution of a savings and loan holding company with an affiliate engaged in the business activites specified in subparagraphs (F) and (G) or subsection (c)(2) of this section except for clause (ii) of subparagraph (F); unless the context otherwise requires, such transactions by an insured institution shall be subject to the same limitations and prohibitions specified in sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371 c and d) as if such insured institution were a member bank. The Corporation may prescribe rules or regulations for purposes of defining and clarifying the applicability of the limitations and prohibitions described in the preceding sentence.".

"(d) Section 408 (e) of the National Housing Act (12 U.S.C. 1730a(e)) is amended by striking out clause (ii) of subparagraph (1)(B) and inserting in lieu thereof the following:

"(ii) acquired in connection with a reorganization in which a person or group of persons exchange their shares of an insured institution for shares of a newly formed holding company and receive, after such reorganization, substantially the same proportional share interest in the holding company as they held in the insured institution, except for changes in shareholder interests resulting from the exercise of dissenting shareholder rights under State law.".

"(e) Section 408(n) of the National Housing Act (12 U.S.C. 1730a) is amended to read as follows:

"(n) No State shall prohibit the affiliation of an association, as that term is defined in section 2 of the Home Owners' Loan Act of 1933, with a company engaged solely in one or more of the activities described in subparagraphs (F) and (G) of subsection (c)(2) of this section.".

AMENDMENTS TO THE HOME OWNERS' LOAN ACT OF 1933

SEC. 109. (a) Section 5(c) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(c)) is amended by amending subparagraph (B) of paragraph (4) to read as follows:

"(B) SERVICE CORPORATIONS.—Investments in any 'depository institution service corporation', as that term is defined in the Depository Institution Service Corporation Act (12 U.S.C. 1861, et seq.) and in accordance with the requirements, conditions, and limitations specified in that Act: *Provided,* That any association that is a qualified thrift lender, as defined in section 408 of the Natonal Housing Act, may make investments in capital stock, obligations, or other securities of any corporation organized under the laws of the State in which the home office of the association is located, if the entire capital stock of such corporation is available for purchase only by savings and loan associations of such State and by Federal associations having their home offices in such State, but no association may make any investment under this subparagraph if its aggregate outstanding investment under this subparagraph would exceed 3 per centum of the assets of the association, except that not less than one-half of the investment permitted under this subparagraph which exceeds 1 per centum of assets shall be used primarily for community, inner city, and community developent purposes.".

(b) Section 5(q) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(q)) is amended by adding at the end thereof the following:

"(6) Any action for injunctive relief that may be commenced by any person pursuant to paragraph (2) of this provision, may be commenced on the behalf of such person by any trade association of which such person is a member: *Pro-*

vided, That any such action commenced by a trade association shall be subject to the same requirements, limitations and conditions as would be applicable had such action been commenced by any such person pursuant to paragraph (2) of this provision."

BANK SERVICE CORPORATION ACT

SEC. 110. The Bank Service Corporation Act (12 U.S.C. 1861 et seq.) is amended to read as follows:

"SHORT TITLE AND DEFINITIONS

"SECTION 1. (a) This Act may be cited as the Depository Institution Service Corporation Act.

"(b) For purposes of this Act—

"(1) the term 'appropriate Federal supervisory agency' shall include 'appropriate Federal banking agency' as defined in section 1813(q) of this title (12 U.S.C. 1813(q)) and the Federal Home Loan Bank Board with respect to any 'insured institution' as defined in section 1730a(a)(1)(A) of this title (12 U.S.C. 1730a(a)(1)(A)) other than a qualified thrift lender as defined in section 408 of the National Housing Act;

"(2) the term 'Depository Institution Service Corporation' means a corporation organized to perform services authorized by this Act, all of the capital stock of which is owned by one or more depository institutions;

"(3) the term 'depository institution' means any institution subject to examination and supervision by any 'appropriate Federal supervisory agency';

"(4) the term 'invest' includes any advance of funds to a Depository Institution Service Corporation, whether by the purchase of stock, the making of a loan, or otherwise, except a payment for rent earned, goods sold and delivered, or services rendered prior to the making of such payment; and

"(5) the term 'principal investor' means the depository institution that has the largest dollar amount invested in the capital stock of a Depository Institution Service Corporation. In any case where two or more depository institutions have equal dollar amounts invested in a Depository Institution Service Corporation, the corporation shall, prior to commencing operations, select one of the depository institutions as its principal investor and shall notify the depository institution's appropriate Federal supervisory agency of that choice within five business days of its selection.

"AMOUNT OF INVESTMENT IN DEPOSITORY INSTITUTION SERVICE CORPORATION

"SEC. 2. Notwithstanding any limitation or prohibition otherwise imposed by any provision of law exclusively relating to any depository institution, a depository institution may invest not more than 10 per centum of paid-in and unimpaired capital and unimpaired surplus in Depository Institution Service Corporations. No depository institution shall invest more than 5 per centum of its total assets in Depository Institution Service Corporations.

"PERMISSIBLE DEPOSITORY INSTITUTION SERVICE CORPORATION ACTIVITIES FOR DEPOSITORY INSTITUTIONS

"SEC. 3. A depository institution may invest in one or more Depository Institution Service Corporations that perform, and a Depository Institution Service Corporation may perform, the following services only for depository institutions and credit unions: check and deposit sorting and posting; computation and posting of interest and other credits and charges; preparation and mailing of checks, statements, notices and similar items; credit information, appraising, construction loan inspection, and abstracting; developing and administering personnel benefit programs; research, studies, and surveys; purchasing office supplies, furniture and equipment; developing and operating storage facilities for microfilm or other duplicate records; and clerical, bookkeeping, accounting, statistical, data processing, internal auditing, and similar functions performed for a depository institution.

"SERVICES TO NONSTOCKHOLDERS

"SEC. 4. No Depository Institution Service Corporation shall unreasonably discriminate in the provision of any services authorized under this Act to any depository institution that does not own stock in the service corporation on the basis of the fact that the nonstockholding institution is in competition with an institution service that owns stock in the depository institution corporation, except that—

"(1) it shall not be considered unreasonable discrimination for a Depository Institution Service Corporation to provide services to a nonstockholding institution only at a price that fully reflects all of the costs of offering those services, including the cost of capital and a reasonable return thereon; and

"(2) a Depository Institution Service Corporation may refuse to provide services to a nonstockholding institution if comparable services are available from another source at competitive overall costs, or if the providing of services would be beyond the practical capacity of the service corporation.

"REGULATION AND EXAMINATION OF DEPOSITORY INSTITUTION SERVICE CORPORATIONS

"SEC. 5. (a) A Depository Institution Service Corporation shall be subject to examination and regulation by the appropriate Federal supervisory agency of its principal investor to the same extent as its principal investor. The appropriate Federal supervisory agency of the principal shareholder of such a Depository Institution Service Corporation may authorize any other Federal supervisory agency that supervises any other shareholder of the Depository Institution Service Corporation to make such an examination.

"(b) A Depository Institution Service Corporation shall be subject to the provisions of the Financial Institutions Supervisory Act of 1966 as if such service corporation were the same type of depository institution as its principal investor, except that the appropriate Federal supervisory agency of the principal investor shall be authorized to apply such provisions to a Depository Institution Service Corporation.

"(c) Notwithstanding subsection (a) of this section, whenever a depository institution that is regularly examined by an appropriate Federal supervisory agency, or any subsidiary or affiliate of such a depository institution that is subject to examination by that agency, causes to be performed for itself, by contract or otherwise, any services authorized under this Act, whether on or off its premises—

"(1) such performance shall be subject to regulation and examination by such agency to the same extent as if such services were being performed by the depository institution itself on its own premises, and

"(2) the depository institution shall notify such agency of the existence of the service relationship within thirty days after the making of such service contract or the performance of the service, whichever occurs first.

"(d) The appropriate Federal supervisory agencies are authorized to issue such regulations and orders as may be necessary to enable them to administer and to carry out the purposes of this Act and to prevent evasions thereof.

"GRANDFATHER RIGHTS

"SEC. 6. (a) Notwithstanding any other provision of law—

"(1) any service corporation owned by one or more depository institutions and acquired or maintained and operated pursuant to the Bank Service Corporation Act of 1982 (12 U.S.C. 1861 et seq. (1982, repealed 1983)) or pursuant to subparagraph (B)(4) of section 5(c) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(c)(B)(4)) and any regulations promulgated thereunder, may engage in those activities in which (i) it was lawfully engaged on July 1, 1983, and (ii) it has been engaged continuously since July 1, 1983; and

"(2) any depository institution that (i) lawfully invested in a service corporation within the meaning of paragraph (1) of this subsection as of July 1, 1983, and (ii) continuously maintained an investment in such a service corporation since July 1, 1983, may maintain and increase such investment, provided that any such investment is made and maintained in accordance with all conditions, requirements, and limitations applicable thereto under the laws described in paragraph (1) of this subsection.

"(b) The authority conferred by subsection (a) of this section shall terminate, with respect to any covered service corporation, at such time as such service corporation expands its activities to include any new activity, or, with respect to any covered depository institution with an investment in such a service corporation, at such time as such depository institution invests in excess of the limitations set forth in subsection (a)(2) of this section in any service corporation: *Provided,* That any appropriate Federal supervisory agency may, upon application by a service corporation or depository institution that would be required to terminate activities of or divest stockownership in a service corporation, authorize such service corporation or depository institution to maintain its activities or stock interest for an appropriate period of time in the public interest, but in no event shall such time period exceed one year.

"MUTUAL THRIFT SERVICE CORPORATIONS

"SEC. 7. Notwithstanding any other provision of law, any association, which is organized and continues to operate in the mutual form, is authorized to invest in the capital stock, obligations, or other securities of any corporation organized under the laws of the State in which the home office of the mutual organization is located, if the entire capital stock of such corporation is available for purchase only by savings and loan associations of such State and by Federal associations having their home offices in such State, but no mutual organization may make any investment under this section if its aggregate outstanding investment under this section would exceed 3 per centum of the assets of the mutual organization, except that not less than one-half of the investment permitted under this section shall be used primarily for community, inner city, and community development purposes. This section shall be interpreted under the Home Owners' Loan Act of 1933, and regulations lawfully promulgated thereunder as of July 1, 1983.".

TITLE II—CREDIT UNION AMENDMENTS

SECOND MORTGAGE LOANS

SEC. 201. Section 107(5)(A)(ii) of the Federal Credit Union Act (12 U.S.C. 1757(5)(A)(ii)) is amended by inserting after "maturity not to exceed fifteen years" the following: "or any longer term which the Board may choose to allow".

MEMBERSHIP SHARES

SEC. 202. Section 107(6) of the Federal Credit Union Act (12 U.S.C. 1757)(6)) is amended to read as follows:

"(6) to receive from its members, from other credit unions, from an officer, employee, or agent of those nonmember units of Federal, Indian, Tribal, State, or local governments and political subdivisions thereof enumerated in section 207 of this Act and in the manner so prescribed, from the Central Liquidity Facility, and from nonmembers in the case of low-income members (as defined by the Board) funds for credit deposit accounts and payments on (A) shares which may be issued at varying dividend rates; (B) share certificates which may be issued at varying dividend rates and maturities; (C) share draft accounts authorized under section 205(f); and (D) membership shares; subject to such terms, rates, and conditions as may be established by the board of directors, within limitations prescribed by the Board.".

FAITHFUL PERFORMANCE

SEC. 203. Section 112 of the Federal Credit Union Act (12 U.S.C. 1761a) is amended by striking out the third sentence and inserting in lieu thereof the following: "The board shall elect from their number a financial officer who shall give adequate fidelity coverage in accordance with section 122 of this Act.".

MEMBERSHIP OFFICER

SEC. 204. Section 113 of the Federal Credit Union Act (12 U.S.C. 1761b) is amended by striking out "of the board of directors" in paragraph (1) and inserting in lieu thereof "of the credit union.".

POWERS OF THE BOARD OF DIRECTORS

SEC. 205. Section 113 of the Federal Credit Union Act (12 U.S.C. 1761b) is amended—

(1) by striking out paragraph (2) and inserting in lieu thereof the following:

"(2) provide adequate fidelity coverage for officers and employees having custody of or handling funds according to regulations issued by the Board;";

(2) by striking out paragraph (7) and inserting in lieu thereof the following:

"(7) determine whether a membership share will be established, the maximum number of shares, share certificates, and share draft accounts and the classes of shares, share certificates, and share draft accounts;";

(5) by striking out paragraph (11) and inserting in lieu thereof the following:

"(11) establish the par value of the membership share (if any) and the share;" and

(6) by striking out paragraph (18) and inserting in lieu thereof the following:

"(18) declare the dividend rate to be paid on shares, share certificates, share draft accounts, and membership shares pursuant to the terms and conditions of section 117;".

NONPARTICIPATION IN THE CREDIT UNION

SEC. 206. Section 118 of the Federal Credit Union Act (12 U.S.C. 1764) is amended—

(1) by striking out "subject to" in subsection (a) and inserting in lieu thereof "except as provided in"; and

(2) by inserting "and enforce" after "adopt" in Subsection (b).

CHANGE IN INSURANCE STATUS

SEC. 207. Section 206(d)(2) of the Federal Credit Union Act (12 U.S.C. 1786(d)(2)) is amended to read as follows:

"(2) No credit union shall convert from status as an insured credit union under this Act as provided under subsection (a)(2) of this section until the proposition for such conversion has been approved by a majority of all the directors of the credit union and by affirmative vote of a majority of the members of the credit union who vote on the proposition. Following approval by the directors, written notice of the proposition and of the date set for the membership vote shall be delivered in person to each member, or mailed to each member at the address for such member appearing on the records of the credit union, not more than thirty nor less than seven days prior to such date. The written notice of the proposition shall in boldface type state that the issue will be decided by a majority of the members who vote. The membership shall be given the opportunity to vote by mail ballot. If the proposition is approved by the membership, prompt and reasonable notice of insurance conversion shall be given to all members.".

TITLE III—BANKERS BANKS

AMENDMENT TO SECTION 5136 OF THE REVISED STATUTES

SEC. 301. The paragraph numbered "Seventh" of section 5136 of the Revised Statutes (12 U.S.C. 24 (Seventh)) is amended by striking out "*Provided further,* That" and all that follows through the end thereof and inserting in lieu thereof the following: "*Provided further,* That notwithstanding any other provision of this paragraph, the association may purchase for its own account shares of stock of a bank or a holding company which owns or controls such a bank if (1) the stock of such bank or company is owned exclusively (except to the extent directors' qualifying shares are required by law) by depository institutions, and (2) such bank or company and all subsidiaries thereof are engaged exclusively in providing services for depository institutions, their parent holding companies, subsidiaries thereof, and the officers, directors, and employees of each. In no event shall the total amount of stock held by the association in any bank or holding company described in the immediately preceding proviso exceed at any time 10 per centum of the association's capital stock and paid-in and unimpaired surplus and in no event shall the purchase of such stock result in an association's acquiring more than 5 per centum of any class of voting securities of such bank or company.".

AMENDMENT TO SECTION 5169 OF THE REVISED STATUTES

SEC. 302. Section 5169(b)(1) of the Revised Statutes (12 U.S.C. 27(b)(1)) is amended to read as follows:

"(b)(1) The Comptroller of the Currency may also issue a certificate of authority to commence the business of banking pursuant to this section to a national banking association if (A) such association or its parent holding company is owned exclusively (except to the extent directors' qualifying shares are required by law) by depository institutions, and (B) the association, its parent holding company, and all subsidiaries thereof are organized to engage exclusively in providing services for depository institutions, their parent holding companies, subsidiaries thereof, and the officers, directors, and employees of each.".

AMENDMENTS TO THE DEPOSITORY INSTITUTION MANAGEMENT INTERLOCKS ACT

SEC. 303. (a) Section 202(3) of the Depository Institution Management Interlocks Act (12 U.S.C. 3201(3)) is amended—

(1) by striking out "; or" after paragraph (C) and inserting in lieu thereof a period; and

(2) by striking out paragraphs (D) and (E).

(b) Section 205(6) of the Depository Institution Management Interlocks Act (12 U.S.C. 3204(6)) is amended to read as follows:

"(6) A Federal Home Loan Bank or any bank or the parent holding company thereof organized specifically to serve depository institutions, their parent holding companies, subsidiaries thereof, and the officers, directors, and employees of each.".

AMENDMENTS TO THE BANK HOLDING COMPANY ACT OF 1956

SEC. 304. (a) Section 2(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)) is amended by inserting after the first sentence thereof the following: "The term 'bank' also includes a State chartered bank or a national banking association if (1) such bank or its parent holding company is owned exclusively (except to the extent directors' qualifying shares are required by law) by depository institutions, and (2) such bank, its parent holding company, and all subsidiaries thereof are organized to engage exclusively in providing services for depository institutions, their parent holding companies, subsidiaries thereof, and the officers, directors, and employees of each.".

(b) Section 4(c)(14)(F) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)(14)(F)) is amended—

(1) by striking the period after clause (i) and inserting in lieu thereof a semicolon;

(2) by inserting "and" after clause (ii);

(3) by striking out clause (iii) and inserting in lie thereof the following:

"(iii) notwithstanding any other provision of law, the term 'bank holding company' shall include a bank if (1) such bank or its parent holding company is owned primarily by depository institutions, and (2) such bank, its parent holding company, and all subsidiaries thereof are organized to engage exclusively (except as provided in this paragraph) in providing services for depository institutions, their parent holding companies, subsidiaries thereof, and the officers, directors, and employees of each. No depository institution, owning stock in a bank or a holding company described in this clause which invests in an export trading company, shall extend credit to an export trading company in an amount exceeding at any one time 10 per centum of such depository institution's capital and surplus."; and

(4) by striking out clause (iv).

TITLE IV—COMPETITIVE SAVINGS INCENTIVE

SHORT TITLE

SEC. 401. This title shall be referred to as the "Competitive Savings Incentive Act of 1983".

MONEY MARKET DEPOSIT ACCOUNTS

SEC. 402. Section 19(c) of the Federal Reserve Act (12 U.S.C. 461) is amended by adding at the end thereof the following new paragraph:

"(3) Notwithstanding any other provision of law, reserves held by—

"(A) any bank, savings and loan association or mutual or stock savings bank against accounts authorized by section 327 of the Garn-St Germain Depository Institutions Act of 1982 and regulations promulgated thereunder or transaction accounts authorized after December 1, 1982, pursuant to section 327 of the Garn-St Germain Depository Institutions Act of 1982 or sections 203 and 204 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (12 U.S.C. 3502 and 3503); or

"(B) any insured credit union against any comparable accounts authorized by section 117 of title I of the Federal Credit Union Act (12 U.S.C. 1763) and regulations promulgated thereunder,

may be in the form of vault cash, or as deposits in an Earnings Participation Account at a Federal Reserve Bank which shall receive earnings to be paid each month at the rate earned on the securities portfolio of the Federal Reserve System during that month. The earnings on such portfolio shall be passed through on a prorated basis to the depository institutions which maintain reserves pursuant to this paragraph. The Board may prescribe rules and regulations concerning the maintenance and administration of Earnings Participation Accounts under this paragraph.".

TITLE V—CONSUMER LEASES AND RENTAL-PURCHASE AGREEMENTS

SHORT TITLE

SEC. 501. This title may be cited as the "Consumer Lease and Rental-Purchase Agreement Act".

AMENDMENT TO THE CONSUMER CREDIT PROTECTION ACT

SEC. 502. The Consumer Credit Protection Act is amended by adding at the end thereof the following new title:

"TITLE X—CONSUMER LEASE AND RENTAL-PURCHASE ACT

"Chap.	Sec.
"1. General Provisions	101
"2. Consumer Leases and Rental-Purchase Agreements	111
"3. Enforcement and Liability	121
"4. Miscellaneous	131

"CHAPTER 1—GENERAL PROVISIONS

"Sec.
"101. Short title.
"102. Findings and declaration of purpose.
"103. Definitions and rules of construction.
"104. Exempted transactions.
"105. Regulations.

"CHAPTER 2—CONSUMER LEASES AND RENTAL-PURCHASE AGREEMENTS

"Sec.
"111. General requirements of disclosure.
"112. Consumer lease disclosures.
"113. Consumer's liability at early termination or at the end of the lease term.
"114. Rental-purchase disclosures.
"115. Renegotiations and extensions.
"116. Consumer lease advertising.
"117. Rental-purchase advertising.

"CHAPTER 3—ENFORCEMENT AND LIABILITY

"Sec.
"121. Administrative enforcement.
"122. Civil liability.
"123. Defenses.
"124. Liability of assignees.
"125. Criminal liability.

"CHAPTER 4—MISCELLANEOUS

"Sec.
"131. Relation to State laws.
"132. Effect on governmental agencies.
"133. Reports by Board and Attorney General.
"134. Effective date.

"TITLE X—CONSUMER LEASE AND RENTAL-PURCHASE ACT

"CHAPTER 1—GENERAL PROVISIONS

"§ 101. Short title

"This title may be cited as the 'Consumer Lease and Rental-Purchase Act'.

"§ 102. Findings and declaration of purpose

"(a) The Congress finds that the leasing of consumer goods continues to be a popular alternative to installment credit purchases. It is the purpose of this title to assure a more meaningful disclosure of the terms of leases of personal property for personal, family or household purposes, permitting the consumer to compare more readily the various lease terms available; to limit the potential balloon payment in consumer leases to a reasonable amount; and to assure accurate disclosures of lease terms in advertising.

"(b) The Congress also finds that a significant number of consumers have begun to acquire ownership of personal property through rental-purchase agreements. These rental-purchase agreements have been offered without adequate cost disclosures. It is the purpose of this statute to assure meaningful disclosure of the terms of rental-purchase agreements; to make the consumer aware of the total cost of the agreement; to inform the consumer when ownership will transfer; and to assure accurate disclosures of rental terms in advertising.

"§ 103. Definitions and rules of construction

"(a) The following definitions apply to this title:

"(1) 'Advertisement' means a commercial message in any medium that aids, promotes, or assists directly or indirectly a consumer lease or a rental-purchase agreement.

"(2) 'Agricultural purposes' includes the production, harvest, exhibition, marketing, transportation, processing, and manufacture of agricultural products by a natural person who cultivates, plants, propagates, or nurtures those agricultural products, including but no limited to the acquisition of farmlands, real property with a farm residence, and personal property and services used primarily in farming.

"(3) 'Board' refers to the Board of Governors of the Federal Reserve System.

"(4) 'Consumer' means a natural person who leases personal property under a consumer lease or rents personal property under a rental-purchase agreement.

"(5) 'Consumer lease' means a contract in the form of a lease or bailment for the use of personal property, and the purchase of services incidental thereto, by a natural person primarily for personal, family, or household purposes, for a period exceeding four months, in which the total lease cost is not more than $25,000, whether or not the consumer has the option to purchase or otherwise become the owner of the property at the expiration of the lease. The term does not include any 'credit sale' as defined in title I.

"(6) 'Consummation' means the time a consumer becomes contractually obligated on a consumer lease or rental-purchase agreement.

"(7) 'Lessor' means a person who regularly provides the use of property through consumer leases or rental-purchase agreements and to whom the obligation is initially payable on the face of the lease or rental-purchase agreement.

"(8) 'Personal property' means any property that is not real property under the laws of the State where it is located when it is made available for a consumer lease or a rental-purchase agreement.

"(9) 'Rental-purchase agreement' means an agreement for the use of personal property by a natural person primarily for personal, family, or household purposes, for an initial perod of four months or less (whether or not there is any obligation beyond the initial period) that is automatically renewable with each payment and that permits the consumer to become the owner of the property. The term does not include any 'credit sale' as defined in title I.

"(10) 'Residual value' means the wholesale or retail fair market value of the leased property at early termination or the end of the lease term in a consumer lease.

"(11) 'State' refers to any State, the Commonwealth of Puerto Rico, the District of Columbia, and any territory or possession of the United States.

"(b) Unless the context indicates otherwise, the term 'lease' means consumer lease, and the term 'agreement' means rental-purchase agreement.

"(c) Any reference to any provisions of this title includes reference to the regulations of the Board under this title.

"§ 104. Exempted transactions

"This title does not apply to the following:

"(1) Consumer leases and rental-purchase agreements primarily for business, commercial, or agricultural purposes, or those made with government agencies or instrumentalities or with organizations.

"(2) A lease of a safe deposit box.

"(3) A lease or bailment of personal property which is incidental to the lease of real property, and which provides that the consumer has no liability for the value of the property at scheduled expiration except for abnormal wear and tear and that the consumer has no option to purchase the leased property.

"§ 105. Regulations

"(a) The Board shall write regulations to carry out the purposes of this title, to prevent its circumvention, and to facilitate compliance with its requirements. The regulations may contain classifications and differentiations and may provide for adjustments and exceptions for any class of transaction.

"(b) The Board shall publish model disclosure forms and clauses to facilitate compliance with the disclosure requirements and to aid the consumer in understanding the transaction. In designing forms, the Board shall consider the use by lessors of data processing or similar automated equipment. Use of the models shall be optional. A lessor who properly uses the models shall be deemed to be in compliance with the disclosure requirements.

"(c) Any regulation of the Board, or any amendment or interpretation thereof, that requires a disclosure different from the disclosures previously required shall have an effective date of October 1 that follows the date of promulgation by at least six months. The Board may at its discretion lengthen that period of time to permit lessors to adjust their forms to accommodate new requirements. The Board may also shorten that period of time if it makes a specific finding that such action is necessary to comply with the findings of a court or to prevent unfair or deceptive practices. In any case, lessors may comply with any newly promulgated disclosure requirement prior to its effective date.

"CHAPTER 2—CONSUMER LEASES AND RENTAL-PURCHASE AGREEMENTS

"§ 111. General requirements of disclosure

"(a) The lessor shall disclose to the consumer the information required by this title. In a transaction involving more than one consumer, a lessor need disclose to only one of the consumers who are primarily obligated. In a transaction involving more than one lessor, only one lessor need make the disclosures.

"(b) The disclosures shall be made at or before consummation of the consumer lease or rental-purchase agreement.

"(c) The disclosures shall be made clearly and conspicuously in writing, in a form that the consumer may keep. The disclosures required under sections 112 and 114 shall be segregated from all other terms, data, or information provided.

"(d) Information required to be disclosed may be given in the form of estimates and identified as such when the lessor does not know the exact information.

"(e) If a disclosure becomes inaccurate as the result of any act, occurrence, or agreement after delivery of the required disclosures, the resulting inaccuracy is not a violation of this title.

"§ 112. Consumer lease disclosures

"For each consumer lease, the lessor shall disclose the following items, as applicable:

"(1) The total of initial payments required at or before consummation of the lease or delivery of the property, whichever is later.

"(2) The number, amounts, and timing of scheduled payments.

"(3) The total of scheduled payments.

"(4) The total of amounts payable at the expiration of the lease (not including any difference between the anticipated residual value and the actual residual value).

"(5) The total lease cost, which is the sum of items (1), (3), and (4).

"(6) The amount of any required security deposit.

"(7) When the consumer buys required insurance from or through the lessor, the total cost. When the consumer does not buy required insurance from or through the lessor, a statement that the consumer must buy insurance and that the cost is not included in the numerical disclosures.

"(8) When any official fees and taxes are paid to or through the lessor, the total cost. When any official fees or taxes are not paid to or through the lessor, a statement that the consumer must pay official fees or taxes and that the amounts are not included in the numerical disclosures.

"(9) Any dollar charge or percentage amount that may be imposed for a late payment, other than a deferral or extension charge.

"(10) A statement that the consumer may be liable for additional amounts if the lease is terminated early.

"(11) When the consumer's liability is based on the residual value of the property, a statement that the consumer may have the property appraised at the consumer's expense by an independent third party agreed to by the consumer and lessor, and that the parties will be bound by the appraisal.

"(12) When the consumer's liability at the end of the lease term is based on the anticipated residual value of the property:

"(A) The anticipated residual value of the property, marked as wholesale or retail;

"(B) A brief statement of the consumer's potential liability at the end of the lease term;

"(C) The product of three times the average payment allocable to a month; and

"(D) A statement that the consumer's liability will generally be limited to item (12)(C) unless the excess is a result of excessive use or unreasonable wear and use, or the lessor brings a successful court action proving that the estimate of the anticipated residual value was reasonable.

"(13) A statement that the consumer may have other costs and that the consumer should refer to the appropriate lease document for information about nonpayment and default, wear and use standards, and maintenance responsibility.

"§ 113. Consumer's liability at early termination or at the end of the lease term

"(a) When the consumer's liability at the end of the lease term is based on the anticipated residual value of the leased property, the anticipated residual value shall be a reasonable estimate of the actual residual value of the property at the end of the lease term. There shall be a rebuttable presumption that the anticipated residual value is unreasonable to the extent that it exceeds the actual residual value at the end of the lease term by more than three times the average payment allocable to a month. The lessor shall not collect any amount in excess of three times the average payment allocable to a month unless the lessor brings a successful action in court providing that the estimate was reasonable. If the lessor fails to rebut the presumption, the lessor must pay the costs of the action and the consumer's reasonable attorney's fees.

"(b) The presumption in subsection (a) shall not apply to the extent that the excess of the anticipated residual value over the actual residual value is due to damage to the property beyond reasonable wear and use or to excessive use. The lessor may set reasonable standards for wear and use in the lease.

"(c) Subsection (a) does not preclude the right of a willing consumer and lessor to make a mutually agreeable final adjustment with respect to the excess of three times the average payment allocable to a month, provided the agreement is made after the end of the lease term.

"(d) In the lease the lessor may specify penalties or other charges for delinquency, default, or early termination, if the amounts are reasonable in light of the anticipated or actual harm caused by the delinquency, default, or early termination, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy.

"(e) When the consumer's liability is based on the residual value of the leased property, the consumer may obtain at the consumer's expense a professional appraisal of the property by an independent third party agreed to by both parties. This appraisal shall be binding on the parties.

"§ 114. Rental-purchase disclosures

"For each rental-purchase agreement, the lessor shall disclose the following items, as applicable:

"(1) The number, amounts and timing of all payments necessary to acquire ownership of the property.

"(2) The number of payments and the total of payments necessary to acquire ownership of the property.

"(3) A statement that the consumer will not own the property until the consumer has made the number of payments and the total of payments necessary to acquire ownership.

"(4) A statement that the total of payments does not include other charges, such as late payment, default, pickup, and reinstatement fees, and that the consumer should see the contract for an explanation of these charges.

"(5) A statement that the consumer is responsible for the fair market value of the property if it is lost, stolen, damaged, or destroyed.

"(6) A statement indicating whether the property is new or used.

"§ 115. Renegotiations and extensions

"(a) A renegotiation occurs when an existing consumer lease or rental-purchase agreement is satisfied and replaced by a new lease or agreement undertaken by the same lessor and consumer. A renegotiation is a new lease or agreement requiring new disclosures. However, events such as the following shall not be treated as renegotiations:

"(1) The addition or return of property in a multiple-item lease or agreement or the substitution of the leased property, if in either case the average payment allocable to a payment period is not changed by more than 25 per centum.

"(2) A deferral or extension of one or more periodic payments, or portions of a periodic payment.

"(3) A reduction in charges in the lease or agreement.

"(4) A lease or agreement involving a court proceeding.

"(5) Any other event described in regulations prescribed by the Board.

"(b) No disclosures are required for any extension of a consumer lease or a rental-purchase agreement. However, a lessor that extends or permits a consumer to extend a consumer lease for more than one month beyond the end of the lease term shall (for purposes of section 113) recalculate the anticipated residual value of the leased property to reflect the depreciation resulting from the extended term.

"§ 116. Consumer lease advertising

"(a) If an advertisement for a consumer lease states the amount of any payment or states that any or no initial payment is required, the advertisement must also clearly and conspicuously state the following items, as applicable:

"(1) That the transaction advertised is a lease.

"(2) The total of initial payments required at or before consummation of the lease or delivery of the property, whichever is later.

"(3) That a security deposit is required.

"(4) The number, amounts, and timing of scheduled payments.

"(5) For a lease in which the consumer's liability at the end of the lease term is based on the anticipated residual value of the property, that an extra charge may be imposed at the end of the lease term.

"(b) Any owner or personnel of any medium in which an advertisement appears or through which it is disseminated shall not be liable under this section.

"§ 117. Rental-purchase advertising

"(a) If an advertisement for a rental-purchase agreement refers to or states the amount of any payment or the right to acquire ownership, the advertisement must also clearly and conspicuously state the following items, as applicable:

"(1) That the transaction advertised is a rental-purchase agreement.

"(2) The total of payments necessary to acquire ownership.

"(3) That the consumer acquires no ownership rights if the total amount necessary to acquire ownership is not paid.

"(b) Any owner or personnel of any medium in which an advertisement appears or through which it is disseminated shall not be liable under this section.

"CHAPTER 3—ENFORCEMENT AND LIABILITY

"§ 121. Administrative enforcement

"(a) Compliance with the requirements imposed by this title shall be enforced under—

"(1) section 8 of the Federal Deposit Insurance Act, in the case of—

"(A) national banks, by the Comptroller of the Currency;

"(B) member banks of the Federal Reserve System (other than national banks), by the Board; and

"(C) banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), by the Board of Directors of the Federal Deposit Insurance Corporation; and

"(2) section 5(d) of the Home Owners' Loan Act of 1933, section 407 of the National Housing Act, and sections 6(i) and 17 of the Federal Home Loan Bank

Act, by the Federal Home Loan Bank Board (acting directly or through the Federal Savings and Loan Insurance Corporation), in the case of any institution subject to any of those provisions;

"(3) the Federal Credit Union Act, by the National Credit Union Administration with respect to any Federal credit union;

"(4) the Packers and Stockyards Act, 1921 (except as provided in sections 406 of that Act), by the Secretary of Agriculture with respect to any activities subject to that Act; and

"(5) the Farm Credit Act of 1971, by the Farm Credit Administration with respect to any Federal land bank, Federal land bank association, Federal intermediate credit bank, or production credit association.

"(b) For the purpose of the exercise by any agency referred to in subsection (a) of its powers under any Act referred to, a violation of a requirement imposed by this title shall be deemed to be a violation of a requirement imposed under that Act. In addition to its powers under any provision of law specifically referred to in subsection (a), each agency may exercise any other authority conferred on it by law in enforcing any requirement imposed under this title.

"(c) Except to the extent that enforcement of the requirements imposed by this title is specifically committed to some other agency under subsection (a), the Federal Trade Commission shall enforce the requirements. For the purpose of exercising its functions and powers under the Federal Trade Commission Act, a violation of any requirement imposed by this title shall be deemed a violation of a requirement imposed under that Act. All of the functions and powers of the Federal Trade Commission under the Federal Trade Commission Act are available to the Commission to enforce compliance by any person with the requirements imposed by this title, whether or not that person is engaged in commerce or meets any other jurisdictional tests in the Federal Trade Commission Act.

"(d) The authority of the Board to issue regulations under this title does not impair the authority of any other agency designated in this section to make rules respecting its own procedures in enforcing compliance with requirements imposed by this title.

"§ 122. Civil liability

"(a) Except as otherwise provided in this title, a lessor who fails to comply with a requirement of sections 111, 112, 113, 114, or 115 with respect to a consumer is liable to the consumer in an amount equal to the sum of—

"(1) actual damages sustained by the consumer as a result of the violation;

"(2) in the case of an individual action relating to a consumer lease, 25 per centum of the total of scheduled payments under the lease, but not less than $100 nor greater than $1,000;

"(3) in the case of an individual action relating to a rental-purchase agreement, 25 per centum of the total of payments necessary to acquire ownership, but not less than $100 nor greater than $1,000;

"(4) In the case of a class action, the amount the court determines to be appropriate with no minimum recovery as to each member. The total recovery in any class action or series of class actions arising out of the same violation may not be more than the lesser of $500,000 or 1 per centum of the net worth of the lessor. In determining the amount of the award in any class action, the court shall consider, among other relevant factors, the amount of actual damages awarded, the frequency and persistence of the violation, the lessor's resources, and the extent to which the lessor's violation was intentional; and

"(5) the costs of the action and reasonable attorney's fees as determined by the court.

"(b) In the case of an advertisement, any lessor who fails to comply with the requirements of sections 116 and 117 with regard to any person is liable to that person for actual damages suffered from the violation, the costs of the action, and reasonable attorney's fees.

"(c) When there are multiple lessors, liability shall be imposed only on the lessor who made the disclosures. When no disclosures have been given, liability shall be imposed on all lessors.

"(d) When there are multiple consumers in a consumer lease or a rental-purchase agreement, there shall be only one recovery of damages under subsection (a) for a violation of this title.

"(e) Multiple violations in connection with a single consumer lease or rental-purchase agreement entitle the consumer to a single recovery under this section.

"(f) An action under this section may be brought in any United States district court or in any other court of competent jurisdiction within one year of the date of the occurrence of the violation, except that in the case of a violation under section 113 an action may be brought within one year of the end of the lease term. This subsection does not bar a consumer from asserting a violation of this title in an action to collect the debt brought more than one year from the date of the occurrence of the violation as a matter of defense by recoupment or setoff, except as otherwise provided by State law.

"(g) A consumer may not take any action to offset any amount for which a lessor is potentially liable under subsection (a) against any amount owed by the consumer, unless the amount of the lessor's liability has been determined by judgment of a court of competent jurisdication in an action in which the lessor was a party. This subsection does not bar a consumer then in default on the obligation from asserting a violation of this title as an original action, or as a defense or counterclaim to an action brought by the lessor to collect amounts owed by the consumer.

"§ 123. Defenses

"(a) A lessor is not liable under sections 121, 122, or 125 for a violation of the requirements of sections 111, 112, and 114 if within sixty days after discovering the error, and before an action under section 122 is filed or written notice of the error is received from the consumer, the lessor notifies the consumer of the error and makes whatever adjustments in the account are necessary to assure that the consumer will not be required to pay an amount in excess of the amounts actually disclosed. This provision applies whether the discovery of the error was made through a final written examination report or the lessor's own procedures.

"(b) A lessor is not liable under section 122 for a violation of this title if the lessor shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error even though the lessor maintained procedures reasonably adapted to avoid such error. Examples of a bona fide error include, but are not limited to, clerical, calulation, computer malfunction and programing, and printing errors. An error of legal judgment with respect to the requirements of this title is not a bona fide error.

"(c) A lessor is not liable under this title for any act done or omitted in good faith in conformity with any rule, regulation, interpretation, or approval promulgated by the Board or by an official duly authorized by the Board. This rule applies even if, after the act or omission has occurred, the rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

"§ 124. Liability of assignees

"(a) For purposes of sections 122 and 123, the term 'lessor' as used in those sections shall include an assignee of the lessor. However, a civil action for a violation of this title may be brought against an assignee only if the violation is apparent on the face of the disclosure statement. A violation apparent on the face of the disclosure statement includes, but is not limited to, a disclosure that can be determined to be incomplete or inaccurate from the face of the disclosure statement or other documents assigned. An assignee has no liability where the assignment is involuntary.

"(b) In an action by or against an assignee, the consumer's written acknowledgement of receipt shall be conclusive proof that the disclosures were made, provided the assignee had no knowledge that disclosures had not been made when the assignee acquired the obligation.

“§ 125. Criminal liability

“A fine of $5,000 or a prison term of not more than one year, or both, may be imposed on anyone who willfully and knowingly fails to comply with any requirement imposed under this title.

“CHAPTER 4—MISCELLANEOUS

“§ 131. Relation to State laws

“(a) This title does not annul, alter, or affect the laws of any State regarding the disclosure of consumer leases or rental-purchase agreements, nor does this title exempt any person subject to the provisions of this title from complying with the laws of any State with respect to consumer leases or rental-purchase agreements, except to the extent those laws are inconsistent with any provision of this title, and then only to the extent of the inconsistency. The laws of a State are inconsistent if a person is unable to comply with them without violating a provision of this title. The Board is authorized to determine whether such inconsistencies exist.

“(b) The Board shall by regulation exempt from the requirements of this title any class of lease transactions and rental-purchase agreements within any State if it determines that the State law contains requirements substantially similar to those imposed by this title or gives greater protection and benefit to the consumer, and that there is adequate provision for enforcement.

"(c) Except as specified in sections 122 and 123, this title does not affect the validity or enforceability of any contract or obligation under State or Federal law.

"(d) Determinations under this section may be requested by any State.

"§ 132. Effect on governmental agencies

"No civil or criminal penalty provided by this title for violations may be imposed on the United States or any of its departments or agencies, any State or political subdivision, or any agency of any State or political subdivision.

"§ 133. Reports by Board and Attorney General

"Each year the Board and the Attorney General shall report to the Congress concerning the administration of their functions under this title, including any recommendations necessary or appropriate. In addition, the Board's report shall include its assessment of the extent to which compliance with the requirements imposed by this title is being achieved.

"§ 134. Effective date

"(a) This title shall take effect on the October 1 that is at least two years after the date of its enactment.

"(b) All regulations, forms, and clauses required to be prescribed shall be promulgated one year prior to such effective date.

"(c) Notwithstanding subsections (a) and (b), any lessor may comply with the requirements of this title, in accordance with the regulations, forms, and clauses prescribed by the Board, prior to such effective date.".

CONFORMING AMENDMENTS

SEC. 503. (a) Section 102 of the Truth in Lending Act is amended by striking out "(a)" before "The Congress" and by striking out subsection (b).

(b) Section 105(b) of such Act is amended by striking out "or lessee", by striking out "or lessors", and by striking out "or lessor" each place it appears.

(c) Section 105(d) of such Act is amended by striking out ", or chapter 5", by striking out "or lessors" each place it appears, and by striking out "or lessor".

(d) Section 121(a) of such Act is amended by striking out "a consumer lease or", and by striking out "or lessor".

(e) Section 121(b) of such Act is amended by striking out "or one lessor as defined in section 181(3)," and by striking out "or lessor" each place it appears.

(f) Section 122(b) of such Act is amended by striking out "or lessor" and by striking out "chapters 4 and 5" and inserting in lieu thereof "chapter 4".

(g) Section 130(a) of such Act is amended by striking out "or 5", by striking out "(i)", by striking out "or (ii) in the case of an individual action relating to a consumer lease under chapter 5 of this title, 25 per centum of the total amount of monthly payments under the lease,", and by striking out "or 5".

(h) Section 130(b) of such Act is amended by striking out "or chapter 5".

(i) Section 130(d) of such Act is amended by striking out "or consumer lease".

(j) Section 130(g) of such Act is amended by striking out "or 5" and by striking out "consumer lease,".

(k) Chapter 5 of title I of the Consumer Credit Protection Act is repealed.

TITLE VI—FAIR DEPOSIT AVAILABILITY

SHORT TITLE

SEC. 601. This title may be cited as the "Fair Deposit Availability Act of 1983".

DEFINITIONS

SEC. 602. As used in this title—

(1) the term "depository institution" means—

(A) Any insured bank as defined in section 3 of the Federal Deposit Insurance Act or any bank which is eligible to make application to become an insured bank under section 5 of such Act;

(B) any mutual savings bank as defined in section 3 of the Federal Deposit Insurance Act or any bank which is eligible to make application to become an insured bank under section 5 of such Act;

(C) any savings bank as defined in section 3 of the Federal Deposit Insurance Act or any bank which is eligible to make application to become an insured bank under section 5 of such Act;

(D) any insured credit union as defined in section 101 of the Federal Credit Union Act or any credit union which is eligible to make application to become an insured credit union pursuant to section 201 of such Act;

(E) any member as defined in section 2 of the Federal Home Loan Bank Act; and

(F) any insured institution as defined in section 401 of the National Housing Act or any institution which is eligible to make application to become an insured institution under section 403 of such Act;

(2) the term "deposit account" means an account in a depository institution on which the account holder is permitted to make withdrawals by negotiable or transferable instrument, payment orders of withdrawal,

telephone transfers, or other similar items for the purpose of making payments or transfers to third persons or others. Such term includes demand deposits, negotiable order of withdrawal draft accounts, savings deposits subject to automatic transfers, share draft accounts, and all savings deposits and share accounts (other than time deposits); and

(3) the term "Board" means the Board of Governors of the Federal Reserve System.

DISCLOSURE OF FUND AVAILABILITY POLICIES

SEC. 603. (a) Before opening a transaction account, a depository institution shall, in accordance with regulations of the Board, provide a written disclosure to the potential customer of its general policy with respect to when a customer may withdraw funds deposited by check or similar instrument into the customer's deposit account.

(b) A depository institution shall, in accordance with regulations of the Board, either—

(1) furnish its customers preprinted deposit slips, or envelopes for automatic teller machine deposits, bearing a summary statement of its general policy with respect to when a customer may withdraw funds deposited by check or similar instrument into the customer's deposit account; or

(2) in the case of a particular deposit by check or similar instrument into a deposit account for which funds may not be immediately available for withdrawal, provide specific notice of the time the customer may withdraw such funds.

INTEREST ON DEPOSITS

SEC. 604. For the purpose of computing the amount of interest or dividends payable with respect to an interest bearing deposit account, a depository institution may not delay beginning to compute interest on funds deposited by check or similar instrument to such an account beyond the date on which that depository institution receives provisional credit for the check or similar instrument. Nothing in the preceding sentence requires the payment of interest with respect to funds deposited by check or similar instrument which is returned unpaid.

COMPLIANCE WITH ENDORSEMENT STANDARD

SEC. 605. Each depository institution shall place its endorsement on checks and other items described in regulations of the Board in the positions provided for in the endorsement standard (ANSI X 9.3–1981) or in regulations of the Board.

EXPEDITED NOTICE OF NONPAYMENT

SEC. 606. Not later than twenty-four hours after a payor depository institution determines not to pay a check or similar instrument of $250 or more, it shall directly notify the depository institution at which the check was originally deposited of such nonpayment.

DISCLOSURE GUIDELINES

SEC. 607. (a) The Board shall prescribe regulations to carry out this title. These regulations may contain such definitions, classifications, differentiations, or other provisions, and may provide for such adjustments and exemptions for any class of transactions, as the Board determines are necessary.

(b) The Board shall publish model disclosure forms and clauses for common transactions to facilitate compliance with the disclosure requirements of section 603 and to aid customers by utilizing readily understandable language. Nothing in this title may be construed to require the use of any such model form or clause prescribed by the Board under this section. A depository institution shall be deemed to be in compliance with the provisions of section 603 if it (1) uses any appropriate model form or clause as published by the Board, or (2) uses any such model form or clause and changes if by (A) deleting any information which is not required by this title, or (B) rearranging the format.

(c) Model disclosure forms and clauses shall be adopted by the Board after notice duly given in the Federal Register and an opportunity for public comment in accordance with section 553 of title 5, United States Code.

ADMINISTRATIVE ENFORCEMENT

SEC. 608. (a) Compliance with the requirements imposed under this title shall be enforced under—

(1) section 8 of the Federal Deposit Insurance Act in the case of—

(A) national banks, by the Comptroller of the Currency;

(B) member banks of the Federal Reserve System (other than national banks), by the Board; and

(C) banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), by the Board of Directors of the Federal Deposit Insurance Corporation;

(2) section 5(d) of the Home Owner's Loan Act of 1933, section 407 of the National Housing Act, and section 17 of the Federal Home Loan Bank Act, by the Federal Home Loan Bank Board (acting directly or through the Federal Savings and Loan Insurance Corporation), in the case of any institution subject to any of those provisions; and

(3) the Federal Credit Union Act, by the Administrator of the National Credit Union Administration

with respect to any Federal credit union or insured credit union.

(b) For the purpose of the exercise by any agency referred to in subsection (a) of this section of its powers under any Act referred to in that subsection, a violation of any requirement imposed under this title shall be deemed to be a violation of a requirement imposed under that Act. In addition to its powers under any provision of law specifically referred to in subsection (a) of this section, each of the agencies referred to in that subsection may excerise, for the purpose of enforcing compliance with any requirement imposed under this title, any other authority conferred on it by law.

(c) Except to the extent that enforcement of the requirements imposed under this title is specifically committed to some other Government agency under subsection (a) of this section, the appropriate State regulatory authority shall enforce such requirements.

(d) The authority of the Board to issue regulations under this title does not impair the authority of any other authority designated in this section to make rules respecting its own procedures in enforcing compliance with requirements imposed under this title.

CIVIL LIABILITY

SEC. 609. (a) Except as otherwise provided in this section, any depository institution which fails to comply with any requirement imposed under section 603 or 604 with respect to any person is liable to such person in an amount equal to the sum of—

(1) any actual damage sustained by such person as a result of the failure;

(2)(A) in the case of an individual action such additional amount as the court may allow, except that the liability under this subparagraph shall not be less than $50 nor greater than $500; or

(B) in the case of a class action, such amount as the court may allow, except that, as to each member of the class, no minimum recovery shall be applicable, and the total recovery under this subparagraph in any class action or series of class actions arising out of the same failure to comply by the same depository institution shall not be more than the lesser of $500,000 or 1 per centum of the net worth of the depository institution; and

(3) in the case of any successful action to enforce the foregoing liability, the costs of the action, together with a reasonable attorney's fee as determined by the court.

In determining the amount of award in any class action, the court shall consider, among other relevant factors, the amount of any actual damages awarded, the frequency and persistence of failures of compliance, the resources of the depository institution, the number of persons adversely affected, and the extent to which the failure of compliance was intentional.

(b) A depository institution may not be held liable in any action brought under this section for a violation of section 603 or 604 if the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error. Examples of a bona fide error include, but are not limited to, clerical, calculation, computer malfunction and programing, and printing errors, except that an error of legal judgment with respect to a person's obligations under this title is not a bona fide error.

(c) Any action under this section may be brought in any United States district court, or in any other court of competent jurisdiction, within one year from the date of the occurrence of the violation.

(d) No provision of this section imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board or in conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations or approvals under such procedures as the Board may prescribe therefor, notwithstanding that after such act or omission has occurred, such rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

EFFECTIVE DATE

SEC. 610. This title takes effect upon the expiration of twelve months following its enactment.

TITLE VII—CREDIT DEREGULATION AND AVAILABILITY

SHORT TITLE

SEC. 701. This title may be cited as the "Credit Deregulation and Availability Act of 1983".

BUSINESS AND AGRICULTURAL CREDIT

SEC. 702. (a) Section 511 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (94 Stat. 161; Public Law 96-221) is amended to read as follows:

"BUSINESS AND AGRICULTURAL LOANS

"SEC. 511. (a) The provisions of the constitution or the laws of any State prohibiting, restricting, or in any way limiting the rate, nature, type, amount of, or the manner of calculating or providing or contracting for interest, discount, points, a time price differential, finance charges or other fees or charges that may be charged, taken, received, or reserved shall not apply in the case of business or agricultural credit.

"(b) As used in this part, the term—

"(1) 'agricultural credit' means credit extended primarily for agricultural purposes to a person that cultivates, plants, propagates, or nurtures an agricultural product;

"(2) 'agricultural purposes' include the production, harvest, exhibition, marketing, transportation, processing, or manufacturing of an agricultural product and the acquisition of farmland, real property with a farm residence and personal property and services used primarily in farming;

"(3) 'agricultural product' includes agricultural, horticultural, viticultural, and dairy products, livestock, wildlife, poultry, bees, forest products, fish and shellfish and any products thereof, including processed and manufactured products and any and all products raised or produced on farms and any processed or manufactured products thereof;

"(4) 'business credit' means credit extended primarily for business or commercial purposes, including investment, and any credit extended to a person other than a natural person; and

"(5) 'credit' includes all secured and unsecured loans, credit sales, forbearances, advances, renewals and other extensions of credit.".

(b) Section 512 of the Depository Institutions Deregulation and Monetary Control Act of 1980 is amended to read as follows:

"APPLICABILITY

"SEC. 512. (a) Except as provided in subsection (b) of this section, the provisions of this part shall apply with respect to business and agricultural credit extended on or after April 1, 1980.

"(b) The provisions of this part shall not apply to any business or agricultural credit extended in any State after the effective date (if such effective date occurs on or after April 1, 1980, and prior to three years after the effective date of the Credit Deregulation and Availability Act of 1983) of a State law or a certification that the voters of such States have voted in favor of any provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the provisions of this part to apply with respect to credit extensions subject to the laws of such State, except that such provisions shall apply to any credit extended on or after such date pursuant to a commitment to extend such credit which was entered into on or after April 1, 1980, and prior to such later date.

"(c) Credit shall be deemed to be extended during the period to which the provisions of this part apply if such credit extension—

"(1)(A)(i) is funded or made in whole or in part during such period, regardless of whether pursuant to a commitment or other agreement therefor made prior to April 1, 1980;

"(ii) was made prior to or on April 1, 1980, and bears or provides for interest during such period on the outstanding amount thereof at a variable or fluctuating rate; or

"(iii) is a renewal, extension, or other modification of an extension of credit made prior to April 1, 1980, and such renewal or extension or other modification is made during such period with the written consent of any person obligated to repay such credit; and

"(B)(i) has an original principal amount of $25,000 or more ($1,000 or more on or after the date of enactment of the Housing and Community Development Act of 1980 or any amount on or after the effective date of the Credit Deregulation and Availability Act of 1983); or

"(ii) is part of a series of advances if the aggregate of all sums advanced or agreed or contemplated to be advanced pursuant to a commitment or other agreement therefor is $25,000 or more ($1,000 or more on or after the date of enactment of the Housing and Community Development Act of 1980 or any amount on or after the effective date of the Credit Deregulation and Availability Act of 1983); or

"(2) is a renewal, extension, other modification or use of a credit agreement or extension made during such period, including an agreement entered during that period that contemplates future extensions of credit from time to time in which the charges that are assessed for or in connection with credit are calculated from time to time, in whole or in part, on the basis of the outstanding balance and the credit is extended not later than eighteen months after the effective date of the State law or certification.".

CONSUMER CREDIT

SEC. 703. Title V of the Depository Institutions Deregulation and Monetary Control Act of 1980 (94 Stat. 161; Public Law 96-221) is amended by adding at the end thereof the following new part:

"PART D—CONSUMER CREDIT

"CONSUMER CREDIT

"SEC. 531. The provisions of the constitution or laws of any State prohibiting, restricting, or in any way limiting the rate, nature, type, amount of, or the manner of calculating or providing or contracting for covered charges that may be charged, taken, received or reserved shall not apply to an extension of consumer credit made by a creditor.

"DEFINITIONS

"SEC. 532. (a) As used in this part—

"(1) the term 'covered charges' means—

"(A) interest, discount, points, a time price differential, or any similar fees, charges, or other compensation paid to the creditor and arising out of the credit agreement or transaction for the use of credit or credit services. The term shall not include, however, fees, charges or other amounts paid to the creditor or arising out of the credit agreement or transaction that are paid or arise solely as the result of the failure or refusal of the debtor to comply with the terms and conditions of the debtor's agreement with the creditor, including without limitation the fact that the obligation is not repaid in accordance with the payment schedule; and

"(B) fees or charges paid for the availability of credit, payment mechanism services, or for similar purposes, including periodic, transaction and access fees;

"(2) the term 'credit' includes all secured and unsecured loans, credit sales, forbearances, advances, renewals and other extensions of credit, all without regard to the nature of any property that might secure its repayment;

"(3) the term 'creditor' means any person that regularly makes extensions of consumer credit, which, for purposes of this definition, shall include extensions of credit that are subject to the provisions of section 501(a) of this title. A person is not a 'creditor' with respect to a specific extension of consumer credit if, except for this part, in order to assess or collect covered charges in connection with that transaction, the person would be required to comply with licensing requirements imposed under State law, unless such person is licensed under applicable State law and such person remains, or becomes, subject to the applicable regulatory requirements and enforcement mechanisms provided by State law; and

"(4) the term 'extension of consumer credit' means any credit extended to a natural person primarily for personal, family, or household purposes, except that it does not include credit subject to the provisions of section 501(a) or 511(a) of this title.

"APPLICABILITY

"SEC. 533. (a) Except as provided in subsection (b) of this section, the provisions of section 531 shall apply with respect to any extension of consumer credit made by a creditor on or after the effective date of the Credit Deregulation and Availability Act of 1983.

"(b)(1) The provisions of section 531 shall not apply to any extension of consumer credit in any State made on or after the effective date (if such effective date occurs on or after the effective date of the Credit Deregulation and Availability Act of 1983 and prior to a date three years after such effective date) of a State law or a certification that the voters of such State have voted in favor of any provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the provisions of this part to apply with respect to extensions of consumer credit subject to the laws of such State, except that such provisions shall apply to any consumer credit extended on or after such date pursuant to an agreement to extend such credit which was entered into on or after the effective date of the Credit Deregulation and Availability Act of 1983 and prior to such later date.

"(2) Credit shall be deemed to have been extended during the period to which the provisions of this part apply, if it—

"(A) is funded or extended in whole or in part during such period, regardless of whether pursuant to a commitment or other agreement therefor made prior to that period;

"(B) was made prior to such period and bears or provides for covered charges that may vary or fluctuate during that period;

"(C) is a renewal, extension, or other modification of a credit extension made before such period and such renewal, extension or other modification is made during such period with the written consent of any person obligated to repay such credit; or

"(D) is extended in accordance with an agreement entered into prior to the effective date of the State law or certification that contemplates future extensions of consumer credit from time to time in which the covered charges are calculated from time to time, in whole or in part, on the basis of the outstanding balance and the credit is extended not later than eighteen months after the effective date of the State law or certification.

"(c) Any law or certification adopted by a State or its voters pursuant to subsection (b) of this section may specify that portion of the extension of consumer credit made in such State, or those types or kinds of covered charges, to which the provisions of section 531 will not apply.

"INTERPRETIVE AUTHORITY

"SEC. 534. (a) The Board of Governors of the Federal Reserve System is authorized to publish Board interpretations regarding the scope and application of section 531 of this part. Upon its own motion or upon the request of any creditor, State, or other interested party which is submitted to the Board in accordance with procedures it establishes, within one hundred and twenty days the Board shall issue an official interpretation regarding the scope of section 531 and its relationship to specific provisions of State law, or shall make public a Board determination (accompanied by an appropriate explanation) that the question presented does not involve a significant issue or does not affect a substantial number of creditors or extensions of consumer credit.

"(b) No provision of the constitution or laws of any State imposing any liability, penalty, or forfeiture shall apply to any act done or omitted in good faith in conformity with any interpretation under this section by the Board, notwithstanding that, after such act of omission has occurred, such interpretation is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.".

FEDERAL CREDIT UNIONS

SEC. 704. Section 107(5)(A)(vi) of the Federal Credit Union Act (12 U.S.C. 1757(5)(A)(vi)) is amended to read as follows:

> "(vi) rates of interest shall be established by the board of directors of the Federal credit union;".

EFFECTIVE DATE

Sec. 705. This title shall take effect upon its enactment.

TITLE VIII—INTEREST ON DEMAND DEPOSITS

SHORT TITLE

Sec. 801. This title may be cited as the "Demand Deposit Deregulation Act".

AMENDMENTS TO THE FEDERAL RESERVE ACT

Sec. 802. (a) The first and second sentences of section 19(i) of the Federal Reserve Act (12 U.S.C. 371a) are hereby repealed.

"(b) The third sentence of section 19(i) of the Federal Reserve Act is amended by striking out "Notwithstanding any other provision of this section, a" and inserting in lieu thereof "A".

AMENDMENT TO THE FEDERAL DEPOSIT INSURANCE ACT

Sec. 803. The first sentence of section 18(g)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1828(g)(1)) is hereby repealed.

AMENDMENT TO THE HOME OWNERS' LOAN ACT OF 1933

Sec. 804. The second sentence of section 5(b)(1)(B) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(b)(1)(B)) is hereby repealed.

AMENDMENT TO SECTION 19(b) OF THE FEDERAL RESERVE ACT

SEC. 805. Section 19(b) of the Federal Reserve Act (12 U.S.C. 461(b)) is amended by striking the last sentence in subparagraph (8)(A) and inserting in lieu thereof the following: "This subparagraph does not apply to (1) any category of deposits or accounts which are first authorized pursuant to Federal law in any State after April 1, 1980; nor (2) an amount equal to the amount by which current total demand deposits exceeds the amount of demand deposits held by the institution on a daily average basis during the fourteen-day period preceding the date of enactment of this Act, held by each depository institution located outside of Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, and Vermont, except as permitted by order or regulation of the Board.".

AMENDMENT TO THE DEPOSITORY INSTITUTIONS DEREGULATION ACT OF 1980

SEC. 806. Section 204 of the Depository Institutions Deregulation Act of 1980 (12 U.S.C. 3503) is amended by adding at the end thereof a new subsection (d) to read as follows:

"(d) The Deregulation Committee shall not later than six months from the effective date of this Act establish rules permitting the payment of interest on demand deposits at the same rates that are permitted for accounts subject to withdrawal by negotiable or transferable instrument for the purpose of making transfers to third parties authorized under section 2(a) of Public Law 93-100 (12 U.S.C. 1832(a)). Interest may not be paid by a depository institution on any demand deposit until such rules are issued by the Deregulation Committee.".

TECHNICAL AMENDMENTS

SEC. 807. (a) Section 207(b)(2) of the Depository Institutions Deregulation Act of 1980 (12 U.S.C. 3506(b)(2)) is amended to read as follows:

"(2) the first sentence of section 18(g) of the Federal Deposit Insurance Act (12 U.S.C. 1828(g)) is amended by striking out 'payment and' and by striking out ', including limitations on the rates of interest and dividends that may be paid;' ".

(b) Section 207(b)(3) of such Act (12 U.S.C. 3506(b)(3)) is amended to read as follows:

"(3) the second, fourth, and seventh sentences of section 18(g) of the Federal Deposit Insurance Act (12 U.S.C. 1828(g)) are hereby repealed;".

(c) The second sentence of section 203(b) of such Act (12 U.S.C. 3502(b)) is hereby repealed.

NOW ACCOUNTS

SEC. 808. Section 2(a)(2) of Public Law 93-100 (12 U.S.C. 1832(a)) is amended by inserting "political" after the comma following "educational".

EFFECTIVE DATE

SEC. 809. This title shall take effect one hundred and eighty days from the date of enactment, except that section 808 shall take effect on the date of enactment of this Act.

TITLE IX—FRAUDULENT USE OF CREDIT CARDS AND DEBIT CARDS

FRAUDULENT USE OF CREDIT CARDS

SEC. 901. Section 134 of the Truth in Lending Act (15 U.S.C. 1644) is amended to read as follows:

"§ 134. Fraudulent use of credit card

"(a) Whoever—

"(1) knowingly, in a transaction affecting interstate or foreign commerce, uses or attempts or conspires to use any counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card to obtain money, goods, services, or anything else of value which within any one-year period has a value aggregating $1,000 or more;

"(2) with unlawful or fraudulent intent, transports or attempts or conspires to transport in interstate or foreign commerce a counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained;

"(3) with unlawful or fraudulent intent, uses any instrumentality of interstate or foreign commerce to sell or transport a counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card knowing the same to be counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained;

"(4) knowingly receives, conceals, uses, or transports money, goods, services, or anything else of value (except tickets for interstate or foreign transportation) which (A) within any one-year period has a value aggregating $1,000 or more, (B) has moved in or is part of, or which constitutes interstate or foriegn commerce, and (C) has been obtained with a counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card;

"(5) knowingly receives, conceals, uses, sells, or transports in interstate or foreign commerce one or more tickets for interstate or foreign transportation, which (A) within any one-year period have a value aggregating $500 or more, and (B) have been purchased or obtained with one or more counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit cards;

"(6) in a transaction affecting interstate or foreign commerce, furnishes money, property, services, or anything else of value, which within any one-year period has a value aggregating $1,000 or more, through the use of any counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card knowing the same to be counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained;

"(7) in a transaction affecting interstate or foreign commerce, knowingly furnishes, transfers, or obtains a credit card for use in connection with a scheme to defraud a consumer or any other person;

"(8) in a transaction affecting interstate or foreign commerce, with unlawful or fraudulent intent, furnishes, acquires or uses any actual or fictitious credit card account numbers or identification or other access codes, whether alone or together with names of credit card holders, or other information pertaining to a credit card account in any form, and as they may be reflected or retained in any medium; or

"(9) with unlawful or fraudulent intent, possesses five or more counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit cards that have moved in, been a part of, or constituted interstate or foreign commerce, shall be fined not more than $10,000 or imprisoned not more than ten years, or both.

"(b)(1) In determining the aggregate value for the purpose of any provision of subsection (a), there shall be included the dollar value of all transactions by a person using one or more credit cards in a course of conduct in violation of such provision.

"(2) As used in this section, the term 'credit card' includes account numbers or any other means of account access that can be used, alone or in conjunction with another means of access to obtain money, goods, services, or any other thing of value.

"(c) Any person who is convicted of a violation of any provision of subsection (a) or section 916 shall, for any subsequent violation of a provision of subsection (a) or section 916, be fined not more than $100,000 or imprisoned not more than 20 years, or both.".

FRAUDULENT USE OF DEBIT CARDS

SEC. 902. (a) Section 916(b) of the Electronic Fund Transfer Act (15 U.S.C. 1693n(b)) is amended by striking out "obtained—" in paragraph (6) and inserting in lieu thereof the following: "obtained; or

"(7) in a transaction affecting interstate or foreign commerce, knowingly furnishes, transfers, or obtains a debit instrument for use in connection with a scheme to defraud a consumer or any other person; or

"(8) in a transaction affecting interstate or foreign commerce, with unlawful or fraudulent intent, furnishes, acquires, or uses any actual or fictitious account numbers or identification or other access codes, whether alone or together with names of account holders, or other information pertaining to a debit instrument in any form, and as they may be reflected or retained in any medium; or

"(9) with unlawful or fraudulent intent, possesses five or more counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained debit instruments that have moved in, been a part of, or constituted interstate or foreign commerce—".

(b) Section 916(c) of such Act is amended by inserting after "card, code," the following: "account number, other means of account access (that can be used, alone or in conjunction with another access device, to obtain money, goods, services, or any other things of value or for the purpose of initiating a transfer of funds (except a transfer originated solely by a paper instrument)),".

(c) Section 916 of such Act is amended by adding at the end thereof the following:

"(d) In determining the aggregate value for the purpose of any provision of subsection (b), there shall be included the dollar value of all transactions by a person using one or more debit instruments in a course of conduct in violation of such provision.

"(e) Any person who is convicted of a violation of any provision of subsection (b) or of section 134 shall for any subsequent violation of a provision of subsection (b) or section 134, be fined not more than $100,000 or imprisoned not more than 20 years, or both.".

TITLE X—INTERSTATE BANKING

SHORT TITLE

SEC. 1001. This title may be cited as the "Interstate Banking Act of 1983".

AMENDMENT TO SECTION 5155 OF THE REVISED STATUTES

SEC. 1002. The first sentence of subsection (c) of section 5155 of the Revised Statutes (12 U.S.C. 36) is amended—

(1) by striking out "and" before "(2)"; and

(2) by inserting before the period the following: "; and (3) within any other State in which such establishment and operation are at the time authorized to State banks by statute law by language specifically granting such authority affirmatively and not merely by implica-

tion or recognition, subject to any restriction as to location imposed by the laws of the other State on State banks and subject to other limitations in the law of the other State such as the geographic location or proximity of the State in which the association is situated, and subject to such State having in effect a law providing reciprocal treatment of its State banks".

AMENDMENT TO THE BANK HOLDING COMPANY ACT OF 1956

SEC. 1003. Section 3(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1842(d)) is amended by adding at the end thereof the following: "State laws which authorize a bank holding company the banking operations of which are principally conducted in another State to acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional bank located in a State may grant such authority on the basis of limitations such as the geographic location or proximity of such other State or on the basis of such other State having in effect a law providing reciprocal treatment for such transactions.".

AMENDMENTS TO THE HOME OWNERS' LOAN ACT OF 1933

SEC. 1004. (a) Section 5(a) of the Home Owner's Loan Act of 1933 (12 U.S.C 1464(r)) is amended by adding at the end thereof the following:

"(4) An association may establish and operate a branch in any State where the establishment and operation of a branch by an out-of-State association are authorized by statute in language specifically granting such authority affirmatively and not merely by implication or recognition, and subject to any restriction as to location imposed by the laws of the State on State associations. Such statute may grant such authority subject to limitations such as the geographic location or proximity of the other State or subject to such other State having in effect a law providing reciprocal treatment for such establishment and operation.".

(b) Section 5(d)(11) of such Act (12 U.S.C. 1464(d)(11)) is amended—

(1) by inserting "(A)" after "(11)"; and

(2) by adding at the end thereof the following:

"(B) In considering any reorganization or merger involving an association, the Board shall give effect to any State law under which a reorganization or merger involving an association from that State and an association or other financial institution from another State is authorized by statute in language specifically granting such authority affirmatively and not merely by implication or recognition and subject to any restriction as to location imposed by the laws of that State. Such statute may grant such authority subject to limitations such as the geographic location or proximity of the other State or subject to such other State having in effect a law providing reciprocal treatment for such reorganizations or mergers.".

AMENDMENT TO THE NATIONAL HOUSING ACT

SEC. 1005. Section 408(e)(3)(B) of the National Housing Act (12 U.S.C. 1730a(e)(3)(B)) is amended by inserting before the period at the end thereof the following: ", except that the Corporation shall give effect to any State laws which permit a savings and loan holding company whose operations are principally conducted in any other State to acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional association located in that State which laws may permit such acquisition subject to limitations such as the geographic location or proximity of the other State or subject to the other State having in effect a law providing reciprocal treatment for such acquisitions".

AMENDMENTS TO THE FEDERAL DEPOSIT INSURANCE ACT

SEC. 1006. (a) Section 18(d) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)) is amended by adding at the end thereof the following:

"(3) In considering the application of any State nonmember bank, the Corporation shall give effect to any State laws under which the establishment and operation of a branch by an out-of-State nonmember bank are authorized by statute in language specifically granting such authority affirmatively and not merely by implication or recognition and subject to the restrictions as to location imposed by the laws of the State on State nonmember insured banks. Such State laws may grant such authority subject to limitations such as the geographic location or proximity of the other State or subject to such other State having in effect a law providing reciprocal treatment for such establishment and operation.".

(b) Section 18(c)(5) of such Act (12 U.S.C. 1828(c)(5)) is amended—

(1) by redesignating subparagraphs (A) and (B) as clauses (i) and (ii), respectively;

(2) by inserting "(A)" after "(5)"; and

(3) by adding at the end thereof the following:

"(B) In reviewing any merger transaction, the responsible agency shall give effect to the laws of a State under which a merger transaction involving a bank from that State and a bank from another State is authorized by statute in language specifically granting such authority affirmatively and not merely by implication or recognition and subject to any restriction as to location imposed by the laws of that State. Such State laws grant such authority subject to limitations such as the geographic location or proximity of the other State or subject to such other State having in effect a law providing reciprocal treatment for such mergers.".

SUNSET

SEC. 1007. (a) Effective upon the expiration of five years after the date of enactment of this title—

(1) section 5155(c)(3) of the Revised Statutes, as added by section 1002 of this title, is repealed;

(2) section 7(b) of the Bank Holding Company Act of 1956, as added by section 1003 of this title, is repealed;

(3) section 5(r)(4) of the Home Owners' Loan Act of 1933, as added by section 1004 of this title, is repealed;

(4) that part of section 408(e)(3) of the National Housing Act which was added by section 1005 of this title is repealed;

(5) section 18(d)(3) of the Federal Deposit Insurance Act, as added by section 1006 of this title, is repealed;

(6) section 18(c)(5)(B) of the Federal Deposit Insurance Act, as added by section 1007 of this title, is repealed; and

(7) section 5(d)(11) (B) of the Home Owners' Loan Act of 1933, as added by section 1008 of this title, is repealed.

(b) The repeal or termination by subsection (a) of any amendments made by this title shall have no effect on any action taken or authorized while such amendment was in effect. Any bank or other institution the shares or assets of which are acquired in reliance upon the amendments made by this title shall after repeal of the amendments made by this title have the same powers with respect to the establishment of branch offices and merger or consolidation with other institutions, as it would have had if its shares or assets not been so acquired.

REPORT

SEC. 1008. (a) The President, in consultation with the Attorney General, the Secretary of the Treasury, the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, shall transmit a report to the Congress concerning the effect, if any, that this title has had on the financial, economic, and banking environment and on particular banks, bank holding companies, savings and loan associations, and saving banks. There shall be included in this report legislative recommendations as to whether the sunset provisions of section 1009 should be allowed to take effect.

(b) The report required by subsection (a) shall be transmitted to the Congress not later than four years after the date of enactment of this title.

98TH CONGRESS
1ST SESSION

S. 2134

To establish the permissible scope of powers for depository institutions and their holding companies consistent with their safe and sound operations, to simplify the procedures for engaging in such activities, and for other purposes.

IN THE SENATE OF THE UNITED STATES

NOVEMBER 18 (legislative day, NOVEMBER 14), 1983

Mr. PROXMIRE introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To establish the permissible scope of powers for depository institutions and their holding companies consistent with their safe and sound operations, to simplify the procedures for engaging in such activities, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Depository Institutions Holding Company Act Amendments of 1983".

AMENDMENTS TO THE BANK HOLDING COMPANY ACT

SEC. 2. Section 2 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841), is hereby amended:

(1) by amending subsection (c) to read as follows:

"(c) 'Bank' means (1) an 'insured bank' as that term is defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)); (2) any institution that is eligible to become an insured bank pursuant to section 5 of the Federal Deposit Insurance Act (12 U.S.C. 1815); or (3) any institution organized under the laws of the United States, any State of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands, that accepts deposits that the depositor may withdraw by check or similar means for payment to third parties and is engaged in the business of making commercial loans. The term 'bank' does not include (A) any foreign bank having an insured branch in the United States; (B) an insured institution; (C) any organization operating under section 25 or section 25(a) of the Federal Reserve Act; (D) any organization that does not do business in the United States except as an incident to its activities outside the United States; or (E) any institution that functions solely as a trust company, such as the type described in section 92a(a) of title 12, United States Code, and all or substantially all of the deposits of which are received solely in a fiduciary capacity."; and

(2) by inserting after subsection (i) the following new subsections:

"(j) The term 'securities affiliate' means any corporation that (1) is engaged in the United States in one or more of the activities authorized pursuant to section 4(c)(15) of this Act, and (2) is a broker or dealer within the meaning of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78c(a)(4) and (5)), or an investment adviser within the meaning of the Investment Advisers Act of 1940, as amended (15 U.S.C. 80b–2(11)). For purposes of this chapter, a corporation engaged in any such activities shall be deemed to be a securities affiliate only so long as it is a bank holding company or is owned or controlled by a bank holding company.

"(k) the term 'insured institution' has the meaning ascribed to it in section 408 of the National Housing Act (12 U.S.C. 1730a(a)(1)).".

SEC. 3. Section 3 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1842), is hereby amended by deleting the word "or" before the letter "(B)" in the second sentence of subsection (a) thereof and by adding the following new subparagraph immediately preceding the period at the end of the second sentence of subsection (a): "; or (C) with thirty days prior notification to the Board, the acquisition by a company of control of a bank in a reorganization in which a person or group of persons exchange their shares of the bank for shares of a newly formed bank holding company and receive after such reorganization, substantially the same proportional share interest in the holding company as they held in the bank except for changes in shareholder interests resulting from the exercise of dissenting shareholder rights under State or Federal law: *Provided,* That, immediately following such acquisition, the bank holding company meets the capital and other financial standards prescribed by the Board by regulation for such a bank holding company and the holding company does not engage in any activities other than those of banking or managing and controlling banks. In promulgating regulations pursuant to this subsection, the Board shall not require more capital for the subsidiary bank immediately following the reorganization that is required for a similarly sized bank that is not a subsidiary of a bank holding company".

SEC. 4. Subsection 4(a)(2) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1843(a)(2)), is hereby amended:

(1) by amending subparagraph (B) of such subsection to read as follows: "(B) those permitted under paragraphs (8) and (15) of subsection (c) of this section subject to all the conditions and requirements specified in each respective paragraph or in any order or regulation issued by the Board under such paragraphs"; and

(2) by adding the following additional proviso at the end of such subsection: ":*Provided further,* (I) That the two-year period referred to in this paragraph shall

not apply to a company that becomes a bank holding company as a result of enactment of the Depository Institutions Holding Company Act of 1983, and that acquired a bank between June 23, 1983, and the effective date of such Act; and (II) That a company that becomes a bank holding company as a result of the enactment of the Depository Institutions Holding Company Act of 1983, and that controlled an insured bank on June 23, 1983, may engage in any activity in which it was lawfully engaged, directly or indirectly, on June 23, 1983, and in which it has been engaged continuously since June 23, 1983: *Provided,* That any activities authorized for such a bank holding company may not be expanded and any additional activities may not be commenced except in accordance with the requirements, conditions, and limitations applicable to bank holding companies under this Act. The authority conferred by the preceding clause (II): (a) shall terminate at such time as (1) any bank holding company covered by clause (II) acquires control of an additional bank or an insured institution, (2) any of such bank holding company's existing subsidiary banks commences accepting deposits that the depositor has a legal right to withdraw on demand and engages in the business of making commercial loans, or (3) such bank holding company covered by clause (II) commences, directly or indirectly, after June 23, 1983, any additional activities, other than those activities authorized pursuant to this Act, in which it was not engaged on June 23, 1983; and (b) may be terminated by the Board by order, after opportunity for hearing, if it determines, having due regard to the purposes of this chapter, that such action is necessary to prevent conflicts of interests or unsound banking practices or is in the public interest.".

SEC. 5. Subsection 4(c) of the Bank Holding Company Act of 1956, as amended (12 U.S.C 1843(c)), is hereby amended:

(1) by deleting paragraph (8) and replacing it with the following new paragraph:

"(8)(A) shares of any company the activities of which the Board has determined by regulation, or by order after notice, to be closely related to banking or managing or controlling banks.

"(B)(i) No bank holding company shall engage directly or indirectly in any activity authorized under this paragraph either de novo or by an acquisition in whole or in part of a going concern, unless the Board has been given sixty days prior written notice of such proposal and, within such period, the Board has not issued an order disapproving the proposal or suspending the time period in accordance with clause (iii) of this subparagraph.

"(ii) An acquisition may be made prior to the expiration of the disapproval period specified in clause (i) of this subparagraph, if the Board issues a written notice of its intent not to disapprove the transaction. The Board may provide for no notice under this paragraph or notice for a shorter period of time with respect to particular activities. No notice under this paragraph is required in the event a bank holding company establishes de novo an office to engage in any activity previously authorized for such a bank holding company under this paragraph, or changes the location of an office engaged in such activity, unless the company has been notified that a notice is required based upon any of the criteria specified in clause (iv) of this subparagraph.

"(iii) Any notice required under this paragraph shall contain such information as the Board may prescribe by regulation or by specific request in connection with a particular notice. The Board may require only such information as may be relevant to the nature, scope, or permissibility of the proposed activity and to the Board's evaluation of the criteria in clause (iv) of this subparagraph. In the event the Board requires additional relevant information beyond that provided in the notice submitted pursuant to this paragraph, the Board may by order suspend the time period provided in clause (i) of this subparagraph until it has received such additional relevant information. The activity that is the subject of the notice may be commenced at the expiration of thirty days from the date of receipt by the Board of such additional relevant information, unless the Board issues a disapproval order as provided in clause (i) of this subparagraph or at such earlier date as may be authorized under clause (ii) of this subparagraph. A suspension order issued under this clause is reviewable under section 9 of this Act.

"(iv) In evaluating a notice under this paragraph, the Board may consider the following criteria:

"(I) the managerial resources of the companies involved;

"(II) the adequacy of their financial resources, including their capital, giving consideration to the financial resources and capital of others engaged in similar activities: *Provided*, That the Board shall not require a higher level of capital for any activity subject to Federal or State regulation than would be required by the applicable regulatory authority for a company engaged in such activity, unless the Board shall find that particular circumstances warrant a higher level of capital;

"(III) any practice or arrangement that may adversely affect the independence or impartiality of an affiliated bank in the provision of credit or other services or the terms on which such credit and services are made available, or the availability of such credit; and

"(IV) any material adverse effect on the safety and soundness or financial condition of an affiliated bank or banks.

"(v) The Board shall by order set forth the reasons for any disapproval under this paragraph. Inaction on any notice, or a Board order determining not to disapprove a proposal to engage in an activity that has previously been authorized by regulation under this paragraph, shall be final and shall not be subject to judicial review under this Act or in any other manner. Any company may obtain judicial review pursuant to section 9 of this Act of any Board order not to disapprove a notice filed by such company under this paragraph if such order contains restrictions or conditions.

"(vi) A bank holding company may petition the Board to determine by regulation that a particular activity is closely related to banking. The Board may by regulation prescribe limitations on the conduct of any activity authorized under paragraph (8) or (15) of this subsection consistent with the criteria in clause (iv) of this subparagraph and with safe and sound financial practices. In administering this paragraph, the Board shall promote competition between bank holding companies and other companies engaged in activities closely related to banking.

"(vii) The Board shall not after the date of enactment of this paragraph designate as an activity closely related to banking within the meaning of this paragraph any activity that is described in clauses (i) and (ii) of subparagraph (B) of paragraph (15) of this subsection or that is prohibited to a member bank or to an affiliate of a member bank under sections 16 (12 U.S.C. 24 (Seventh)) or 20 (12 U.S.C. 377) of the Banking Act of 1933, as amended.

"(viii) Notwithstanding any other provision of this Act, if the Board finds that an emergency exists which requires the Board to act immediately on any notice or application under this subsection involving a thrift institution, and the primary Federal regulator of such institution concurs in such finding, the Board may dispense with any notice or other requirement of this subsection.

"(C) For purposes of this paragraph, it is not closely related to banking or managing or controlling banks for a bank holding company to provide insurance as a principal, agent, or broker except (i) where the insurance is limited to assuring repayment of the outstanding balance due on a specific extension of credit by a bank holding company or its subsidiary in the event of the death, disability, or involuntary unemployment of the debtor; (ii) in the case of a finance company which is a subsidiary of a bank holding company, where the insurance is also limited to assuring repayment of the outstanding balance on an extension of credit in the event of loss or damage to any property used as collateral on such extension of credit and such extension of credit is not more than an amount equal to $10,000 ($25,000 in the case of an extension of credit which is made to finance the purchase of a residential manufactured home and which is secured by such residential manufactured home) increased by the percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers published monthly by the Bureau of Labor Statistics for the period beginning on January 1, 1982, and ending on December 31 of the year preceding the year in which such extension of credit is made; (iii) any insurance agency activity in a place that (I) has a population not exceeding five thousand (as shown by the last preceding decennial census), or (II) the bank holding company, after notice and opportunity for a hearing, demonstrates it has inadequate insurance agency facilities; (iv) any insurance agency activity which was engaged in by the bank holding company or any of its subsidiaries on May 1, 1982, or which the Board approved for such company or any of its subsidiaries on or before May 1, 1982, including (I) sales of insurance at new locations of the same bank holding company or the same subsidiary or subsidiaries with respect to which insurance was sold on May 1, 1982, or approved to be sold on or before May 1, 1982, if such new locations are confined to the State in which the principal place of business of the bank holding company is located, any State or States immediately adjacent to such State, and any State or States in which insurance activities were conducted by the bank holding company or any of its subsidiaries on May 1, 1982, or were approved to be conducted by the bank holding company or any of its subsidiaries on or before May 1, 1982, and (II) sales of insurance coverages which may become available after May 1, 1982, so long as those coverages insure against the same types of risks as, or are otherwise functionally equivalent to, coverages sold on May 1, 1982, or approved to be sold on or before May 1, 1982 (for purposes of this subparagraph, activities engaged in or approved by the Board on May 1, 1982, shall include activities carried on subsequent to that date as the result of an application to engage in such activities pending on May 1, 1982, and approved subsequent to that date or of the acquisition by such company pursuant to a binding written contract entered into on or before May 1, 1982, of another company engaged in such activities at the time of the acquisition); (v) any insurance activity where the activity is limited solely to supervising on behalf of insurance underwriters the activities of retail insurance agents who sell (I) fidelity insurance and property and casualty insurance on the real and personal property used in the operations of the bank holding company or any of its subsidiaries, and (II) group insurance that protects the employees of the bank holding company or any of its subsidiaries; (vi) any insurance agency activity engaged in by a bank holding company, or any of its subsidiaries, which bank holding company has total assets of

$50,000,000 or less: *Provided, however,* That such a bank holding company and its subsidiaries may not engage in the sale of life insurance or annuities except as provided in clauses (i), (ii), or (iii) of this subparagraph; or (vii) where the activity is performed, or shares of the company involved are owned, directly or indirectly, by a bank holding company which is registered with the Board of Governors of the Federal Reserve System and which, prior to January 1, 1971, was engaged, directly or indirectly, in insurance agency activities as a consequence of approval by the Board prior to January 1, 1971.".

(2) by adding following paragraph (14) the following new paragraph (15):

"(15) (A) shares of any securities affiliate the activities of which consist of:

"(i) dealing in or underwriting obligations issued or guaranteed by or on behalf of a State or any political subdivision thereof or any agency or instrumentality of either of the foregoing, except industrial development bonds as defined in section 103(b)(2) of the Internal Revenue Code of 1954, as amended: *Provided, however,* That a securities affiliate may deal in and underwrite such industrial development bonds, the interest on which is exempt from Federal income tax under section 103(a) of the Internal Revenue Code of 1954, as amended, if: (I) a State, territory, possession of the United States, or any political subdivision of the foregoing, or the District of Columbia pledges its full faith and credit for the payment of all principal and interest on such bonds or (II) the issuer, or the State or local governmental unit on behalf of which the industrial development bonds were issued, is considered the sole owner, for Federal income tax purposes, of the facility with respect to which financing is to be provided from the proceeds of such industrial development bonds;

"(ii) dealing in or underwriting securities backed by pools of residential mortgage loans;

"(iii) organizing, sponsoring, operating, controlling, providing investment advice to, or underwriting, distributing, or selling the shares of an investment company, as such term is defined in section 3 of the Investment Company Act of 1940, as amended (15 U.S.C. 80a–3); or

"(iv) any securities or securities-related activity that a national or state member bank is not prohibited by law from conducting directly.

"(B) No bank holding company that engages in any activity described in clauses (i), (ii), or (iii) of subparagraph (A) of this paragraph through a securities affiliate shall, after one year from the date on which any such securities affiliate first engages in any of such activities, permit a bank or insured institution controlled by such holding company to engage, directly or indirectly, in the United States in such activities (other than organizing, sponsoring, operating, controlling or providing investment advice to a closed-end investment company) or in any of the following activities: (i) dealing in or underwriting any obligation of the United States and any other obligation listed in paragraph Seventh of section 5136 of the Revised Statutes of the United States, as amended (12 U.S.C. 24), and (ii) purchasing and selling securities and stock as agent. For purposes of this subparagraph, the Board may, by regulation or order, determine additional securities or securities-related activities in which such bank or insured institution may not engage. No rule, regulation or order of the Board, however, shall prohibit a bank or insured institution from engaging in those securities or securities-related activities that are necessary or incidental to the financing of such bank or insured institution or to the investment of its funds. In the event that a securities affiliate controlled by a bank holding company terminates all of the activities specified in clauses (i), (ii), and (iii) of subparagraph (A) of this paragraph, any bank or insured institution that is controlled by such bank holding company may conduct any securities or securities-related activities that it is authorized by law to conduct.

"(C) A bank holding company seeking to acquire shares of a securities affiliate or engage directly in securities or securities-related activities pursuant to this paragraph shall comply with the prior notification and other requirements and limitations of paragraph (8) of this subsection."; and

(3) by deleting the penultimate sentence thereof, which begins "In the event".

SEC. 6. Subsection 5(c) of the Bank Holding Company Act, as amended (12 U.S.C. 1844(c)), is hereby amended to read as follows:

"(c)(1) The Board from time to time may require reports under oath, in such scope and detail as it may determine, of a bank holding company and each subsidiary thereof to keep the Board informed as to whether such companies are complying with the provisions of this Act and regulations and orders issued thereunder.

"(2) Except where the Board determines that a lesser reporting requirement is appropriate, the Board shall accept in fulfillment of the reporting requirements established pursuant to this subsection for nonbank subsidiaries separate reports consisting of: (A) for companies subject to the reporting requirements of section 17 of the Securities Exchange Act of 1934 (15 U.S.C. 78q), the same information required to be submitted to the Securities and Exchange Commission under such section (and the rules and regulations thereunder) at the same time such information is so submitted; and (B) for all other companies the same information as would be required to be submitted under section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) (and the rules and regulations thereunder) by companies subject to the reporting requirements of such Act, that are engaged in the same or similar lines of business, not more frequently than quarterly. In particular circumstances, the Board may require additional information in order to fulfill its responsibilities under this Act.

"(3) The Board may make examinations of each bank holding company and each subsidiary thereof, the cost of which may be assessed against, and paid by, such holding company. The Board shall, however, insofar as possible, minimize the scope and frequency of examinations of nonbank subsidiaries of a bank holding company by utilizing, where feasible, reports of applicable regulatory agencies or other bodies public or private, and by directing, to the extent feasible, the focus of such examinations to the activities or financial condition of such nonbank subsidiaries that may have a materially adverse effect on the safety and soundness or financial condition of a subsidiary bank of the bank holding company.".

SEC. 7. Section 7 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1846), is hereby amended by striking out the period at the end thereof and inserting the following: ": *Provided, however,* That no State shall prohibit the affiliation of a national banking association, as such term is used in section 21 of this title, with a company engaged only in one or more of the activities described in paragraphs (8) and (15) of subsection 4(c) of this Act.".

SEC. 8. Section 11 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1849), is hereby amended by inserting after the fourth sentence of subsection (b) thereof the following new sentence: "The Board may shorten or eliminate this thirty day period with the consent of the Attorney General.".

AMENDMENTS TO THE BANK MERGER ACT OF 1966

SEC. 9. Section 18(c) of the Bank Merger Act of 1966 12 U.S.C. 1828(c), is hereby amended by inserting at the end of paragraph (6) thereof the following new sentence: "The responsible agency may shorten or eliminate this thirty-day period with the consent of the Attorney General.".

AMENDMENTS TO THE BANKING ACT OF 1933

SEC. 10. Section 20 of the Banking Act of 1933, as amended (12 U.S.C. 377), is hereby amended by adding the following new paragraph at the end of the first paragraph of such section:

"Notwithstanding any other provision of this section, a member bank may be affiliated in any manner described in subsection (b) of section 221a of this title with a securities affiliate as defined in section 2(j) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(j)).".

SEC. 11. Paragraph 1 of subsection 21(a) of the Banking Act of 1933, as amended (12 U.S.C. 378(a)(1)), is hereby amended by deleting the word "or" and replacing the semicolon at the end thereof with a period and by adding the following new sentence at the end thereof: "The prohibitions of this paragraph shall apply to any subsidiary (as defined in 12 U.S.C. 1841(d)) of any firm, corporation, association, business trust, or other similar organization engaged in the business of receiving deposits as described herein. A subsidiary of such organization, the activities of which become unlawful as a result of the enactment of the Depository Institutions Holding Company Act Amendments of 1983 may continue its existing activities for a period of two years after the date of enactment of such act; or".

Sec. 12. Section 32 of the Banking Act of 1933, as amended (12 U.S.C. 78), is hereby amended by adding the following sentence at the end thereof: "Notwithstanding any other provision of this section, an officer, director, or employee of any member bank may serve at the same time as an officer, director, or employee of any securities affiliates with which the member bank is affiliated. The term 'securities affiliate' shall have the meaning ascribed to it in section 2(j) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(j)).".

AMENDMENTS TO THE FEDERAL DEPOSIT INSURANCE ACT

Sec. 13. Subsection 18(j) of the Federal Deposit Insurance Act (12 U.S.C. 1828(j)) is amended:

(1) by redesignating paragraphs (3) and (4) as paragraphs (4) and (5), respectively, and by adding the following new paragraph (3):

"(3) The provisions of section 20 of the Banking Act of 1933, as amended (12 U.S.C. 377), relating to affiliations between member banks and organizations engaged principally in certain securities activities, and the provisions of section 32 of the Banking Act of 1933, as amended (12 U.S.C. 78), relating to certain officer, director or employee relationships involving a member bank and a person or organization primarily engaged in certain securities activities, shall be applicable to every nonmember insured bank in the same manner and to the same extent as if such nonmember insured bank were a member bank. An affiliation or officer, director or employee relationship that becomes unlawful as a result of the enactment of this paragraph may continue for a period of two years after the date of enactment of this paragraph. The provisions of this paragraph shall not apply to any foreign bank, as defined in subsection 1(7) of the International Banking Act of 1978, having an insured branch in the United States with respect to any affiliation between such bank and any company organized under the laws of a foreign country that is not engaged in business in the United States except as an incident to its activities outside the United States, and shall not apply to any officer, director, or employee of any such foreign bank, but shall apply to officers and employees of the insured branch."; and

(2) by inserting after the words in the first sentence of paragraph (4)(A), as so redesignated under paragraph (1) of this section, "or any lawful regulations issued pursuant thereto," the following words: "or any provision of section 20 of the Banking Act of 1933, as amended,".

PROHIBITION ON CERTAIN ACTIVITIES BY DEPOSITORY INSTITUTIONS

SEC. 14. Section 2 of Public Law 93-100 (12 U.S.C. 1832) is amended by adding at the end thereof the following new subsection (d):

"(d) No State-chartered depository institution may commence, either directly or indirectly, any activity unless (1) such activity was authorized for that type of institution explicitly and not by implication by a State statute adopted, or by an interpretation promulgated thereunder, prior to January 1, 1983; (2) such activity is permitted under section 4(c)(8) of the Bank Holding Company Act for a bank holding company subject to all applicable limitations; or (3) such activity is explicitly authorized by a State statute, or interpretation promulgated thereunder, and is performed exclusively in the State authorizing such activity for residents of that State. This section does not authorize the conduct of any activity prohibited to a State-chartered depository institutions under sections 20 or 21 of the Glass-Steagall Act. Nothing in this section shall prohibit a State-chartered savings and loan association or savings bank from engaging in any activity expressly permitted for a Federal savings and loan association or Federal savings bank pursuant to the Garn-St Germain Depository Institutions Act of 1982 (Public Law 97-320). Any State-chartered depository institution that after

June 23, 1983, commenced any activity, directly or indirectly, that would have been prohibited by this subsection if commenced after enactment of this subsection shall immediately terminate such activity.".

AMENDMENTS TO THE SECURITIES ACT OF 1933

SEC. 15. Section 4 of the Securities Act of 1933, as amended (15 U.S.C. 77d), is hereby amended by adding a new paragraph (7) at the end thereof:

"(7) Transactions involving offers or sales of equity securities in connection with the acquisition of a bank by a company under the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841 et seq.), if such acquisition occurs solely as part of a reorganization in which a person or group of persons exchange their shares of a bank for shares of a newly formed bank holding company and receive, after such reorganization, substantially the same proportional share interest in the holding company as they held in the bank, except for changes in shareholder interests resulting from the exercise of dissenting shareholder rights under State or Federal law.".

AMENDMENTS TO THE SECURITIES EXCHANGE ACT

SEC. 16. Subparagraphs (i), (ii), and (iii) of paragraph (34)(A) of subsection 3(a) of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78c(a)(34)(A)), are each hereby amended by inserting immediately before the semicolons at the end thereof, the words, "other than a securities affiliate as defined in section 2(j) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(j)).

SEC. 17. Paragraph (b)(1) of section 15B of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78o–4(b)(1)), is hereby amended by striking the word "subsidiaries" in parts (B) and (C) thereof and replacing it with the word, "affiliates".

AMENDMENTS TO THE FEDERAL RESERVE ACT

SEC. 18. (a) The Federal Reserve Act is amended by adding new section 23B immediately following section 23A (12 U.S.C. 371c) thereof to read as follows:

"SEC. 23B. RESTRICTIONS ON TRANSACTIONS WITH AFFILIATES.—(a) A member bank and its subsidiaries may engage in any of the following transactions, only on terms and under circumstances, including credit standards, that are substantially the same as, or at least as favorable to such bank or its subsidiary as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies or, in the absence of comparable transactions, those terms and circumstances that in good faith would be offered to, or would apply to nonaffiliated companies:

"(1) any covered transaction, as defined in section 23A, with an affiliate;

"(2) the sale of securities or other assets, including assets subject to an agreement to repurchase, to an affiliate;

"(3) the payment of money or the furnishing of services to an affiliate, under contract, a lease, or otherwise;

"(4) any transaction in which an affiliate acts as an agent or broker or receives a fee for its services to the bank or any other person; or

"(5) any transaction or series of transactions with a third party, (A) if an affiliate has a financial interest in the third party, or (B) if an affiliate is a participant in such transaction or series of transactions.

For the purposes of this subsection, any transaction by a member bank with any person shall be deemed to be a transaction with an affiliate of such bank to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, such affiliate.

"(b) A member bank and the affiliates of such bank shall not publish any advertisement or enter into any agreement stating or suggesting that the bank shall in any way be responsible for the obligations of its affiliates; however, a member bank and its affiliates may use similar names.

"(c) A member bank and any subsidiary of such bank:

"(1) shall not purchase as fiduciary any securities or other assets from any affiliate unless such purchases are permitted under the instrument creating the fiduciary relationship, by court order, or by law of the jurisdiction under which the trust is administered; and

"(2) whether acting as principal or fiduciary, shall not knowingly purchase or otherwise acquire, during the existence of any underwriting or selling syndicate, any security a principal underwriter of which is an affiliate of such bank; except that this prohibition shall not apply where the purchase of such securities has been approved, prior to the time at which such securities are initially offered for sale to the public, by a majority of the directors of the bank who are not officers or employees of the bank or any affiliate thereof. For the purpose of this paragraph, the term 'security' means a 'security' as defined in section 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(12)); and the term 'principal underwriter' means any underwriter who, in connection with a primary distribution of securities, (A) is in privity of contract with the issuer or an affiliated person of the issuer; (B) acting alone or in concert with one or more persons, initiates or directs the formation of an underwriting syndicate; or (C) is allowed a rate of gross commission, spread, or other profit greater than the rate allowed another underwriter participating in the distribution.

"(d) For the purpose of this section:

"(1) the term 'affiliate' means an 'affiliate' as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371c) excluding a bank; and

"(2) the terms 'bank', 'subsidiary', 'person', and 'security' (other than security as used in subsection (c)) have the same meanings given to them in section 23A of the Federal Reserve Act (12 U.S.C. 371c).

"(e) The Board may prescribe rules and regulations to administer and carry out the purposes of this section, including rules or regulations to (1) further define terms used in this section; (2) exempt transactions or relationships from the requirements of this section; or (3) exclude from the definition of 'affiliate' in this section any subsidiary of a bank holding company, if the Board finds such exemptions or exclusions to be in the public interest and consistent with the purposes of this section.".

(b) Section 18(j) of the Federal Deposit Insurance Act (12 U.S.C. 1828(j)) is hereby amended:

(1) by inserting "and section 23B" after "section 23A" at each place it appears in paragraph (1); and

(2) by inserting ", 23B," after "23A" in paragraph (4)(A), as so redesignated under paragraph (1) of section B of this Act.

AMENDMENTS TO THE INVESTMENT COMPANY AND INVESTMENT ADVISERS ACTS OF 1940

SEC. 19. (a) Subsection 17(f) of the Investment Company Act of 1940, as amended (15 U.S.C. 80a–17(f)), is hereby amended by adding after the words "unit investment trusts": "*Provided, however,* That any registered management company that is organized, sponsored, operated or controlled by, or which receives investment advice from, any securities affiliate, as defined in section 2(j) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(j)), may place and maintain its securities and similar investments in the custody of a bank which is affiliated with such securities affiliate only with the prior approval of the Commission.".

(b) Subsection 26(a)(1) of the Investment Company Act of 1940, as amended (15 U.S.C. 80a–26(a)(1)), is hereby amended by adding after the words "so published);": "*Provided, however,* That, except with the prior approval of the Commission, it shall be unlawful for such trust indenture, agreement of custodianship, or other instrument to designate as trustee or custodian any bank which is affiliated with a securities affiliate, as defined in the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(j)), which organizes, sponsors, operates or controls such registered unit investment trust.".

(c) Subsection 27(c)(2) of the Investment Company Act of 1940, as amended (15 U.S.C. 80a-27(c)(2)), is hereby amended by adding after the words "trust indentures of unit investment trusts": "*Provided, however,* That, except with the prior approval of the Commission, it shall be unlawful to deposit such proceeds with any bank which is affiliated with a securities affiliate, as defined in section 2(j) of the Bank Holding Company Act of 1956 as amended (12 U.S.C. 1841(j)), which organizes, sponsors, operates, controls or renders investment advice to such registered investment company.".

(d) Subsection 202(a)(11) of the Investment Advisers Act of 1940, as amended (15 U.S.C. 80b-2(a)(11)), is hereby amended by inserting after the words "bank holding company" the following: "(other than a bank holding company which is a securities affiliate)".

AMENDMENTS TO BANK HOLDING COMPANY ACT AMENDMENTS OF 1970

SEC. 20. Section 105 of the Bank Holding Company Act Amendments of 1970, (12 U.S.C. 1850), is hereby amended by deleting the words ", to engage directly or indirectly in a nonbanking activity pursuant to section 4 of such Act.".

SEC. 21. Section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972, et seq.), is hereby amended by adding new subsection (i) at the end thereof to read as follows:

"(i) Any action for injunctive relief that may be commenced by any person pursuant to section 1976 of this title may be commenced on the behalf of such person by any trade association of which such person is a member: *Provided,* That any such action commenced by a trade association shall be subject to the same requirements, limitations, and conditions as would be applicable had such action been commenced by any such person pursuant to section 1976 of this title.".

AMENDMENTS TO THE SAVINGS AND LOAN HOLDING COMPANY AMENDMENTS OF 1967

SEC. 22. Section 408 of the National Housing Act (12 U.S.C. 1730a), is hereby amended by deleting subsection (n) thereof and replacing it with the following new subsection (n):

"(n) In the event that (A) an insured institution that is owned or controlled by a unitary savings and loan holding company devotes less than 60 per centum of its assets to residential mortgages and related investments on average during the year; (B) such subsidiary insured institution's services or products are offered to or marketed through such holding company or its other subsidiaries; or (C) the services or products of such holding company or its other subsidiaries are offered to or marketed through such subsidiary insured institution, such unitary savings and loan holding company may not thereafter commence, or continue for more than three years, any business activity not permissible for a multiple savings and loan holding company under paragraph (2) of this subsection. For purposes of determining compliance with the three-year period described in the preceding sentence, the last sentence of paragraph (2) of this subsection shall be inapplicable. For the purposes of this section, the term "related investments" means (i) securities backed by residential mortgages; (ii) retail mobile home loans; (iii) home improvement loans; (iv) loans to finance the construction of residential properties; and (v) investments in service corporations except that such investments shall be reduced by an amount proportionate to the amount of such corporation's assets that are not residential mortgages or related investments as defined in this section.".

The **Chairman**. We may have a slight delay with Secretary Regan. I understand Western Airlines is behind schedule on the nonstop from Washington this morning. If that is the case, when Chairman Volcker is finished, we have arranged with two of our afternoon witnesses to fill in until Secretary Regan gets here.

Before I turn to Chairman Volcker, I'd like to turn to my colleagues and see if they have any remarks they'd like to make at the outset of this hearing.

Senator Gorton.

OPENING STATEMENT OF SENATOR GORTON

Senator **Gorton**. Mr. Chairman, it's a pleasure to be your guest here in Salt Lake City; not for the first hearing on this subject as banking legislation, but for the first hearing on your own proposal dealing with a myriad of aspects of that very complicated issue. I would like to commend you for the bill which you have introduced.

As I am sure is the case with my colleague, I can't claim to agree with every element of it. But it covers all of the major elements of controversy with respect to a field which is growing and changing and evolving very, very rapidly.

As a consequence you, following up on the administration itself, have provided a very real service in giving us something from which to work. Simply to discuss those issues in the abstract is of very little use to us. But to have a bill before us, to have national witnesses such as Mr. Volcker, as well as those who are going to be affected by it in their own communities, comment on it is going to be a great deal of help to you, to me, Senator Lautenberg, and the rest of the committee in coming up with a proper answer to this question.

The **Chairman**. Senator Lautenberg.

OPENING STATEMENT OF SENATOR LAUTENBERG

Senator **Lautenberg**. Thank you, Mr. Chairman. I appreciate very much the opportunity to be here; not only because I am interested very much in the bill that you have proposed, but being in Salt Lake City and in this wonderful State of Utah and not too far from places like Snowbird and Alta helped my decision.

But seriously, it is a pleasure to be here; and the view that you gave us in my hotel room at least, over the temple spires and the capital, is most impressive.

I am pleased to be here for the very serious purpose for which you called the hearing and that is to make sure in a process of changing structure of the financial institutions in our country that we don't leave out some very important parts of its responsibility.

My chief concern is whether or not in the process of change we will forget the farmer or small businessman, the individual consumer who needs to be protected in some way by having available to him or her the credit that's helped build this country over the years, provided the kind of housing that we have become accustomed to. While we slip further into the process of deregulation or change, I am not sure that it's always good.

I do respect the fact that you have called the hearing so early on in your bill and you intend to have it thoroughly reviewed. The fact that Senator Garn mentioned that in an election year things are tough to accomplish, he uses, as usual, his brilliant judgment by inviting two Senators that are not up for reelection this year. So we are safe for a while and we can deal with this thing, hopefully, objectively.

I am pleased to be here with Chairman Volcker, a New Jersey born and bred fellow, and we need that kind of balance out here in the friendly West.

About the largest compliment I have gotten from Senator Garn, as my chairman, is that it needed two Republicans to take care of a single Democrat. But I am pleased to be here as part of this process and I thank you for inviting me.

Thank you, Senator.

The CHAIRMAN. Before I turn to Chairman Volcker, I do think I should mention one more major benefit of holding this hearing in Salt Lake City; that is, the help to the economy, the airlines, the hotels, for the money of all the Washington lobbyists who are here and spent their money getting here to listen to the hearings.

Mr. Chairman, once again, we appreciate your effort in being here and we'd be happy to hear your testimony at this time.

OPENING STATEMENT OF PAUL A. VOLCKER, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. VOLCKER. Thank you, Mr. Chairman. Let me express my own pleasure at getting out of Washington and being able to participate in this hearing at an early date. I will read parts of my statement and summarize other parts.

I want to say, first of all, as you all know, the senior Senator from this State has been leading the effort to achieve constructive and timely responses to the need to change our banking laws to meet today's conditions. In that respect, Mr. Chairman, you follow in the tradition of another native son, Marriner Eccles. As chairman of the Federal Reserve Board for more than 13 years during the 1930's and 1940's, he spearheaded the effort to rewrite banking laws to meet the needs of his time—and for many years thereafter. Your sponsorship, Senator Garn, of legislation to rededicate our office in Washington in his name seems to me appropriate and welcome recognition of a man to whom we owe a great deal in the Federal Reserve.

Drawing on his experience as a businessman and innovative banker in Utah, Marriner Eccles greatly strengthened the Federal Reserve and did much to repair the financial system after the ravages of the banking crisis of the early 1930's and the Depression. He certainly recognized the crucial importance of a sound banking system to the proper functioning of our economy, and the necessary role of the Federal Government in setting out an appropriate legislative framework, supported by effective supervision and regulation. I might say he was, of course, particularly conscious of the responsibilities of the Federal Reserve, as the Nation's central bank, in protecting the stability of the banking system. I am struck by many parallels in reviewing the problems we face today between the basic issues that were before the country then and now.

PRESSURE OF TECHNOLOGICAL AND MARKET CHANGES

But, as you well know, under the pressure of technological and market change, there is also a pressing need to adapt the legislative framework to today's conditions lest crucial continuing objectives of public policy be eroded or overturned. In earlier testimony before you, I have reviewed the dangers of permitting the situation to evolve in haphazard and potentially dangerous ways. The result would be not just unfair competitive distortions but also an unintended unravelling of basic tenents of public policy that the legislative structure has been designed to promote.

Let me just take a minute to summarize our basic approach toward these matters, our point of departure is the basic proposition that banks, and depository institutions generally, continue to perform a unique and critical role in the financial system and the economy—as operators of the payments system, as custodians of the bulk of liquid savings, as key and impartial suppliers of short-term credit to all sectors, and as the link between monetary policy and the economy. The unique role implies continuing governmental concerns about the stability and impartiality of these institutions—concerns that are reflected in the Federal "safety net" long provided by the discount window and by deposit insurance, by regulatory protection against undue risk, and by policies to discourage conflicts of interest and undue concentration of banking resources. We also believe that these concerns must, to a degree, encompass business organizations of which banks are a part—that is, bank holding companies—for the basic reason that a bank or depository institution cannot be wholly separated from the fortunes of its affiliates and from the success or the failure of their business objectives.

Those fundamental concerns we believe are broadly reflected in the proposed legislation before the committee.

There are now two major proposals, S. 2181, which was introduced by the chairman, and S. 2134, introduced by the ranking minority member, Senator Proxmire, who is not here with us this morning. Both of these bills have S. 1069, the administration's proposed Financial Institutions Deregulation Act, which has been endorsed by the Board earlier, as a common base. These bills differ in the scope of new powers authorized bank holding companies and in some other important areas, and I also recognize the point that you made this morning, Mr. Chairman, that inclusion of certain provisions of S. 2181 for discussion purposes does not necessarily imply endorsement. But I also believe it important to emphasize that these bills have key provisions that are identical or similar, suggesting and reflecting an emerging broad consensus on the core of constructive legislation. Thus, I believe the raw materials for coherent action are now before you, providing a strong base for legislative action in a matter of months.

FRAMEWORK FOR LEGISLATIVE ACTION

It seems to me analysis and discussion of these proposals suggest the framework for legislative action can be built on three essential elements:

One, new statutory definitions to clarify what is a bank, what is a thrift, and the proper scope of powers for State-chartered banks;

Two, streamlining of the procedures of the Bank Holding Company Act; and

Three, expansion of the powers of bank holding companies.

Other issues, including new rules for interstate banking and payment of interest on demand deposits and reserves at the Federal Reserve Banks, also need early resolution. As a practical matter, these areas may not have achieved the same degree of consensus. We would like to see progress in those areas and we welcome the efforts of your chairman to advance the discussion. However, we do not believe inability to achieve full agreement in all those areas should necessarily delay legislation dealing with the core elements of the bills before you.

I do believe that there is a broad agreement that new definitions of the terms "banks" and "thrifts" are urgently necessary to assure an orderly framework for the development of the financial system, to promote competitive equity, and to establish clearly the competitive rules for the various segments of the financial services industry. One significant area of possible disagreement—the appropriate role for so-called consumer banks—I will comment upon in a few minutes.

Similarly, with respect to the definition of thrifts, there has been increasingly clear recognition of the anomalies that arise as thrifts achieve and implement powers much more comparable to commercial banks, but still operate under more liberal provisions of law—such as the absence of restrictions on ownership, the ability to obtain long-term governmental lending, favorable tax treatment, and the freedom to branch intrastate and interstate—denied commercial banks. The growing similarity of powers, combined with differences in regulatory approaches, result in competitive inequalities and thus in tensions that undermine legislative intentions. All that is reflected in the strong interest of a variety of financial or nonfinancial businesses in the acquisition of thrifts in order to benefit from banklike powers and to participate in the payments mechanism, but without the restrictions applicable to banks or bank holding companies.

Looked at from another direction, there is recognition of the fact that the public policy rationale for the favorable regulatory, tax, and credit treatment of thrift institutions is fundamentally rooted in their activity as home lenders. Consequently, the essential idea that a thrift should be defined by a test set forth in terms of residential lending activity seems to be increasingly accepted, as well as the corollary that such institutions should not operate in "tandem" with nondepository owners. Again, there are differences on the specifics of the test that need to be resolved and that I will touch upon later.

Recent developments strongly point to the need for another provision defining the role of depository institutions—provisions which provide a framework for the discretion of States in authorizing new powers for State-chartered banking institutions. To the extent Congress, in the national interest, finds it necessary to circumscribe the activities of depository institutions and their holding companies, such limitations could be rendered null and void over time by unrestrained State action.

There are various approaches toward dealing with this anomaly in the dual banking system, reconciling a desirable element of flexibility for the States to experiment with new kinds of banking powers while avoiding developments that undermine the overall policy intent of the Congress with respect to bank and bank holding company powers. What remains is to decide among these approaches. Meanwhile, we at the Board, in view of existing law and expressions of congressional intent, have indicated that we could not approve the acquisition of State-chartered banks by bank holding companies with the apparent intent of undertaking, under relevant State law, widespread insurance activities, beyond the State in which the bank is chartered. This is one illustration of the urgent need for congressional direction in setting appropriate guidelines.

The streamlining of the procedures for dealing with bank holding company applications, and eliminating the burden on applicants to demonstrate net public benefits, is broadly supported by affected institutions and also appears ready for action. In recent amendments to our regulation governing bank holding company activities, the Board has gone as far as it felt it could, consistent with present law, to speed up procedures and lessen regulatory burdens. The approach encompassed in the bills before you would permit further progress in these directions by eliminating the benefits and burdens test of present law, limiting bank holding company examinations and reports, providing for expedited notice procedures for approval of new activities, and setting out new and simplified criteria for determining the permissibility of new activities generally.

DEFINING EXPANDED BANK HOLDING COMPANY POWERS

The third area with which any bill must deal is defining the degree of expanded bank holding company powers. Again, I believe a nascent consensus has developed for a broader test than incorporated in present law. S. 2134 and S. 2181 approach the matter in a somewhat different way; both would have the practical result of permitting and directing the Federal Reserve to permit holding companies to engage in a somewhat broader range of services and the differences between the bills should be reconcilable. Both bills follow the administration proposal on expansion of securities powers of bank holding companies, including revenue bond underwriting, and mutual investment fund powers. All of this has long been supported by the Federal Reserve Board. In addition, both S. 2181 and S. 2134 would further provide for underwriting of mortgage-backed securities. Finally, the latter bill would promote competitive equity in this area by applying the Glass-Steagall Act to nonmembers as well as Federal Reserve member banks.

Proposals to extend powers of bank holding companies to insurance underwriting and brokerage and to real estate brokerage appear, to varying degrees, more controversial. S. 2181 provides one possible approach toward dealing with the concerns about banks acquiring healthy thrifts by limiting such acquisitions across State lines. Various limitations have been suggested for the exercise of real estate development powers. While I will touch upon most of these areas more specifically, we hope and anticipate that further agreement could be reached in the weeks ahead on the basis for proceeding.

I look forward to further opportunities to work with the committee as it reconciles various points of view. But I also want to emphasize as strongly as I can that the basic core elements for constructive legislation do seem to be falling into place, and the opportunity for action is here.

The next portion of my statement, Mr. Chairman, deals more specifically with some major issues that need resolution and I may touch upon them without reading the whole statement.

As you know, title I of S. 2181 and S. 2134 cover the same general matters regarding bank holding companies. You also deal with a great many other related issues in banking. These include authorization for regional interstate banking compacts, interest on demand deposits and on reserves and several other matters.

CHANGES FROM THE ADMINISTRATION BILL

So far as holding company powers are concerned, S. 2181 would make five important changes from the administration bill: limitations on tying of banking and insurance products; some limitations on the scope of real estate development powers; provisions to avoid excessive concentration of resources in the holding company; a change in the definition of the term "bank"; and a change in the proposed thrift definition.

Let me briefly refer to each of those. On the tying provision there certainly has been a question raised as to the necessity for avoiding conflicts of interest by selling or tying to services provided by a bank within a holding company and other parties or the holding company. Present law already restricts the tying by the bank itself and the provisions of your bill go ahead with much more explicit definitive provisions so far as insurance purposes are concerned.

This is an issue we raised in earlier testimony, indicated some concern that if we went with too cumbersome provisions and requirements in this direction, we might put burdens not encountered by other businesses vis-a-vis other financial conglomerates that did not have the same requirements. But we certainly recognize the issue that you are trying to reach and indeed that issue is probably relevant with respect to real estate brokerage as well as with insurance. Within that framework some fair and reasonable safeguards can be developed here that perhaps is a good course between doing nothing, as in present law, and the degree of detail that you have proposed. In the area of real estate development, we are dealing with an area that, to my mind, is very amorphus. What does it include; housing and commercial construction, speculative purchase of land, owning and managing and maintaining office buildings and other commercial properties?

As a whole, that is an area that I think experience has shown to be subject to a good deal of speculation and it is a very risky area cyclically and has led to trouble in the past. There is a more limited approach toward real estate development that our understanding is many banks are primarily interested in whether in conjunction with lending operations, they are able, in effect, to take a passive equity interest and provide a financial package that is more rounded containing both debt and equity limits. But they are not interested, at least many of them apparently, in going to the far-reaching corners of real estate development.

Already the administration bill and your proposal provide some limitations to this by reducing the amount or limiting the amount of capital that a holding company can put in real estate development. We think that is desirable. We think the kind of further step you made to define construction activities is out of real estate development, is appropriate, and we continue to believe that further limitations would be appropriate and we would like to reserve the right to give you some more detailed suggestions after more consultation with the industry.

In any event, we do believe the Board should have clear authority to maintain minimum capital and maximum leveraging provisions for real estate subsidization of a holding company in the interest of the stability of the institutions and the banking system generally.

POSSIBLE DIFFICULTIES OF LARGE HOLDING COMPANIES COMBINED WITH LARGE INSURANCE COMPANIES

You also include, in S. 2181, provisions directed toward another general concern we had expressed about the potential for a concentration of resources. We welcome the effort to explore possibilities for dealing with the possible difficulties of very large holding companies combined, let us say, with very large insurance companies. You suggest a particular test. Our preliminary analysis of that test that would provide that a holding company with more than 0.3 percent of domestic deposits could not invest more than 25 percent of its capital in any one class of permissible nonbanking activities may have some problems.

If you are really getting after the biggest combinations or the biggest banks and the biggest insurance companies, our preliminary analysis suggests that the largest bank holding companies could, under that test, still have controlling interest in even the largest insurance companies.

This is a complicated matter. We are studying it further and would like to see if a somewhat simpler test would achieve the purpose you had in mind. Those don't arise in the context of S. 2134 which wouldn't provide for expansion in the insurance area anyway.

Now, one of the important ways in which S. 2181 differs from the administration proposal is in carving out a major exception to the general definition of a bank. Essentially you would allow something called a consumer bank so long as it was heavily concentrated in consumer lending; would have some, as I understand it, some commercial lending powers but they would be limited. A so-called industrial bank without full deposit powers but with other powers would be exempt from the definition of a bank.

Our concern upon analysis of those provisions, and they are complicated, is that the practical effect would appear to be to permit bank holding companies to engage in interstate consumer banking and particularly in the range of interstate activities that they can undertake indirectly. The issue of interstate banking is an important issue. But our feeling is that it should, and we'd like to see some progress, but it should be proposed more directly.

I realize that the provisions of the bill have tried to avoid having that effect, but through the use of the industrial bank in particular we think it would be possible. It also would clearly be possible for nonbanks, for nonfinancial businesses or investment houses, to own a consumer bank. And again, while there is some method to try to confine that to a single State, we think in the current state of technology, particularly if you permit tandem operations, it would be difficult de facto to avoid those operations operating interstate and more generally it would provide business firms, commercial firms, and investment houses with access to most banking powers and access to the payment system.

We think it is contrary to the thrust of what we are trying, what the administration is trying to achieve and what you are trying to achieve in drawing the borderline appropriately between banks and commerce. So we do have very real problems with that idea of a consumer bank and we believe having that kind of a provision in the bill would, in effect, break down the other restraints on the banking commercial tieup and complex.

It would certainly be unfair, it seems to us, to establish banks that are not consumer banks that can't do all the other activities that every other consumer bank could do. So we would recommend you go back to the definition in the administration bill or S. 2134.

Now, there are definitional questions in terms of thrift. You propose a double-barrel approach based upon the amount of actual mortgage lending and based upon a minimal amount of commercial lending and nets. If less than 25 percent of your assets were in qualifying commercial loans, you would be treated as a holding company and retain those special privileges and liberal treatment.

When we run that through the statistics we find that 75 percent of the commercial banks could be treated as thrifts under that definition because they don't have 25 percent of their assets in commercial loans. At least under a very limited definition of commercial loans. Our basic argument would be, as I indicated earlier, that the unitary thrift concept, and many of the other special provisions applying to thrifts, are really rooted in their mortgage lending and that direct test of activity in the residential mortgage market should be the one applied. In that case the general idea that unitary savings and loan arrangements and the other arrangements supporting the thrift industry would remain in place is entirely acceptable to us. But the emphasis ought to be on mortgage lending.

There is an industry, as you well know, the mutual savings industry, for which that kind of a test would create very great problems and I know of no better effort than a transitional arrangement over a substantial number of years that you could have progressing toward the ultimate test. I would simply, as a concluding point in this area, note that I do believe it's important for a thrift to have limitations on tandem operations with a nonbusiness owner as S. 2134 provides but S. 2181 would not, as now written.

INTERSTATE BANKING

The other comments I will just touch very briefly. We would like to see progress toward interstate banking. We have qualms about this regional idea that is springing up providing a kind of balkanization of the banking system. You would provide Federal authority to support those interstate compacts. We find that acceptable as a transitional device. We wouldn't like to see the country permanently cut up into regional blocks that have arbitrary elements about them. There may be better ways to achieve a transition, but if this is looked upon as a transitional device, and I gather that is essentially what you have in mind, we would just——

The **Chairman**. If I could interrupt at this point, that's not necessarily what I was trying to accomplish. It's a strong feeling I have had with State rights and not to compel them to go into those types of compacts. But this is coming, as you know, primarily from the New England States, six States where the legislatures are dealing with this. So it's more of a States rights with me. If States want to do that, I don't think it is our right as a Federal Government to tell them that they cannot.

So I only interrupted you there rather than waiting for the question period to indicate it is not my intention as a transition but a recognition of States rights and individual legislatures or groups of legislatures to make decisions without Federal interference.

Mr. **Volcker**. I recognize that. I didn't read it as a transition toward full interstate banking but a transition toward some other kind of arrangement simply because you put a sunset on it of 5 years. So in that context—we would like to see it sunsetted, if I may state it that way, because while it does reflect State issues, it could be discriminatory and is discriminatory against banks and States outside the reasons chosen for whatever particular reasons there are to create a particular compact.

I won't bother right now with reviewing the other provisions of your bill. We certainly would be glad to give you further technical and other comments on those provisions but I do simply want to reiterate that I believe that we see things happening that can make all those efforts toward new legislation bear fruit.

It does seem to me that the discussions taking place so far have suggested that there is a core area approaching consensus. There are many difficult issues, but they are reaching the point where they are ripe for a decision and I do think the task is urgent. We have an opportunity to shape the financial system in a manner that both accomodates the market forces but also recognizes the concerns of public policy. But I don't think we have unlimited time for that purpose.

Present arrangements are in disarray and the events are forcing change that may or may not be consistent with considered judgments about public policy. So we want competition and benefits to the consumer inherent in competition but we also want a safe and sound banking system. We want a system that is stable in itself and contributes to a larger economic stability. We think we have to act promptly to maintain that balance.

Thank you.

[The complete statement follows:]

Statement by

Paul A. Volcker

Chairman, Board of Governors of the Federal Reserve System

For a Chairman of the Federal Reserve Board, there is a special pleasure in the opportunity to come to Salt Lake City to participate with the Senate Banking Committee in a discussion of the basic rules to guide the development of our banking system. The senior Senator from this state has been leading the effort to achieve constructive and timely responses to the need to change our banking laws to meet today's conditions. In that respect, Mr. Chairman, you follow in the tradition of another native son, Marriner Eccles. As Chairman of the Federal Reserve Board for more than 13 years during the 1930's and 1940's, he spearheaded the effort to rewrite banking laws to meet the needs of his time -- and for many years thereafter. Your sponsorship, Senator Garn, of legislation to rededicate our office in Washington in his name is an appropriate and welcome recognition of a man to whom we owe a great deal.

Drawing on his experience as a businessman and innovative banker in Utah, Marriner Eccles greatly strengthened the Federal Reserve and did much to repair the financial system after the ravages of the banking crisis of the early 1930's and the depression. He instinctively recognized the crucial importance of a sound banking system to the proper functioning of our economy, and the necessary role of the Federal Government in setting out an appropriate legislative framework, supported by effective supervision and regulation. He was, of course, particularly conscious of the responsibilities of the Federal Reserve, as the Nation's central bank, in protecting the stability of the banking system. He built well, and in reviewing the problems we face today, I am struck by many parallels between the basic issues that were before the country then and now.

But, as you well know, under the pressure of technological and market change, there is also a pressing need to adapt the legislative framework to today's conditions lest crucial continuing objectives of public policy be eroded or overturned. In earlier testimony before you, I have reviewed the dangers of permitting the situation to evolve in haphazard and potentially dangerous ways, influenced not just by natural responses to market forces, but by often capricious effects of existing and now outmoded provisions of law. The result would be not just unfair competitive distortions but also an unintended unravelling of basic tenets of public policy that the legislative structure has been designed to promote.

To summarize our basic approach toward these matters, our point of departure is the basic proposition that banks, and depository institutions generally, continue to perform a unique and critical role in the financial system and the economy -- as operators of the payments system, as custodians of the bulk of liquid savings, as key and impartial suppliers of short-term credit, and as the link between monetary policy and the economy. This unique role implies continuing governmental concerns about the stability and impartiality of these institutions -- concerns that are reflected in the federal "safety net" long provided by the discount window and by deposit insurance, by regulatory protection against undue risk, and by policies to discourage conflicts of interest and undue concentration of banking resources. We also believe that these concerns must, to a degree, encompass business organizations of which banks are a part -- bank holding companies -- for the basic reason that a bank or depository institution cannot be wholly separated from the fortunes of its affiliates and from the success or failure of their business objectives.

Those fundamental concerns are broadly reflected in the proposed legislation before the Committee.

There are now two major proposals, S. 2181, the Financial Services Competitive Equity Act, which was introduced by the Chairman, and S. 2134, the Depository Institutions Holding Company Act Amendments of 1983, introduced by the ranking Minority member, Senator Proxmire. Both of these bills have S. 1069, the Administration's proposed Financial Institutions Deregulation Act, which has been endorsed by the Board, as a common base. These bills differ in the scope of new powers authorized bank holding companies and in some other important areas, and I also recognize that inclusion of certain provisions of S. 2181 for discussion purposes does not necessarily imply endorsement. But I also believe it important to emphasize that these bills have key provisions that are identical or similar, suggesting and reflecting an emerging broad consensus on the core of constructive legislation. Thus, I believe the raw materials for coherent action are now before you, providing a strong base for legislative action in a matter of months.

Points of Growing Consensus

Analysis and discussion of these proposals suggest the framework for legislative action can be built on three essential elements:

(1) New statutory definitions to clarify what is a bank, what is a thrift, and the proper scope of powers for state-chartered banks;

(2) Streamlining of the procedures of the Bank Holding Company Act; and

(3) Expansion of the powers of bank holding companies.

Other issues, including new rules for interstate banking and payment of interest on demand deposits and reserves at the Federal Reserve Banks, also need early resolution. As a practical matter, these areas may not have achieved the same degree of consensus. We would like to see progress in those directions and we welcome the efforts of your Chairman to advance the discussion. However, we do not believe inability to achieve full agreement in all those areas should necessarily delay legislation dealing with the "core" elements of the bills before you.

I do believe that there is a broad agreement that new definitions of the terms "banks" and "thrifts" are urgently necessary to assure an orderly framework for the development of the financial system, to promote competitive equity, and to establish clearly the competitive rules for the various segments of the financial services industry. One significant area of possible disagreement -- the appropriate role for so-called consumer banks -- I will comment upon at a later point.

Similarly, with respect to the definition of thrifts, there has been increasingly clear recognition of the anomalies that arise as thrifts achieve and implement powers much more comparable to commercial banks, but still operate under more liberal provisions of law -- such as the absence of restrictions on ownership, the ability to obtain long-term governmental lending, favorable tax treatment, and the freedom to branch intra-state and inter-state -- denied commercial banks. The growing similarity of powers, combined with differences in regulatory approaches, result in competitive inequalities and thus in tensions that undermine legislative intentions. All that is reflected in the strong interest of a variety of financial or non-financial businesses in the acquisition of thrifts in order to benefit from bank-like powers and to participate in the payments mechanism, but without the restrictions applicable to banks or bank holding companies.

Looked at from another direction, there is recognition of the fact that the public policy rationale for the favorable regulatory, tax, and credit treatment of thrift institutions is fundamentally rooted in their activity as home lenders. Consequently, the essential idea that a thrift should be defined by a test set forth in terms of residential lending activity seems to be increasingly accepted, as well as the corollary that such institutions should not operate in "tandem" with non-depository owners. Again, there are differences on the specifics of the test that need to be resolved and that I will discuss later.

Recent developments strongly point to the need for another provision defining the role of depository institutions -- provisions which provide a framework for the discretion of states in authorizing new powers for state-chartered banking institutions. To the extent Congress, in the national interest, finds it necessary to circumscribe the activities of depository institutions and their holding companies, such limitations could be rendered null and void over time by unrestrained state action.

There are various approaches toward dealing with this anomaly in the dual banking system, reconciling a desirable element of flexibility for the states to experiment with new kinds of banking powers while avoiding developments that undermine the overall policy intent of the Congress with respect to bank and bank holding company powers. What remains is to decide among these approaches. Meanwhile, we at the Board, in view of existing law and expressions of Congressional intent, have indicated that we could not approve the acquisition of state-chartered banks by bank holding companies with the apparent intent of undertaking, under relevant state law, widespread insurance activities, beyond the state in which the bank is chartered. This is one illustration of the urgent need for Congressional direction in setting appropriate guidelines.

The streamlining of the procedures for dealing with bank holding company applications, and eliminating the burden on applicants to demonstrate net public benefits, is broadly supported by affected institutions and also appears ready for action. In recent amendments to our regulation governing bank holding company activities, the Board has gone as far as it felt it could, consistent with present law, to speed up procedures and lessen regulatory burdens. The approach encompassed in the bills before you would permit further progress in these directions by eliminating the "benefits and burdens" test of present law, limiting bank holding company examinations and reports, providing for expedited notice procedures for approval of new activities, and setting out new and simplified criteria for determining the permissibility of new activities generally.

The third area with which any bill must deal is defining the degree of expanded bank holding company powers. Again, I believe a nascent consensus has developed for a broader test than incorporated in present law. S. 2134 and S. 2181 approach the matter in a somewhat different way; both would have the practical result of permitting and directing the Federal Reserve to permit holding companies to engage in a somewhat broader range of services and the differences between the bills should be reconcilable. Both bills follow the Administration proposal on expansion of securities powers of bank holding companies, including revenue bond underwriting, and mutual investment fund powers. All of this has long been supported by the Federal Reserve Board. In addition, both S. 2181 and S. 2134 would further provide for underwriting of mortgage-backed securities. Finally, the latter bill would promote competitive equity in this area by applying the Glass-Steagall Act to nonmembers as well as Federal Reserve member banks.

Proposals to extend powers of bank holding companies to insurance underwriting and brokerage and to real estate brokerage, appear, to varying degrees, more controversial. S. 2181 provides one possible approach toward dealing with the concerns about banks acquiring "healthy" thrifts by limiting such acquisitions across state lines. Various limitations have been suggested for the exercise of real estate development powers. While I will touch upon most of these areas more specifically, we hope and anticipate that further agreement could be reached in the weeks ahead on the basis for proceeding.

I look forward to further opportunities to work with the Committee as it reconciles various points of view. But I also want to emphasize as strongly as I can that the basic "core" elements for constructive legislation do seem to be falling into place, and the opportunity for action is here.

Major Issues That Need Resolution

Title I of S. 2181 draws on the base of the Administration FIDA proposals, but with certain significant changes and additions, including some consistent with my earlier testimony. S. 2134 is also built on the Administration proposals, but is more limited. The remaining Titles of S.2181 deal with a variety of other banking issues. These include: authorization for regional interstate banking compacts; interest on demand deposits and on reserves; pre-emption of state interest rate ceilings on business, agricultural and consumer credit; and federal rules on deposit availability. Finally, the bill also adds provisions on consumer leasing, credit card fraud, expanded powers for credit unions, and an authorization for bankers' banks to invest in export trading companies.

So far as holding company powers are concerned, S. 2181 would make five important changes from the Administration bill: limitations on tying of banking and insurance products; the scope of real estate development; provisions to avoid excessive concentration of resources; the definition of the term bank; and the proposed thrift definition.

I believe there is agreement that tying of the provision of bank credit or other banking services to the sale of products or services by other affiliates of a holding company could impair impartiality in credit decisions and competitive equity. The existing Bank Holding Company Act, Federal Reserve regulations, and anti-trust laws already contain safeguards and prohibitions against conflicts of interest in this area. S. 2181 would add a number of additional limitations and procedural requirements specifically directed toward the linkage of insurance and banking products, to reinforce the prohibition on tying. Similar questions could arise in the real estate brokerage area.

We recognize the concerns that motivate the new provisions. At the same time, cumbersome detailed requirements could impose burdens not encountered by other businesses, including retail, securities and insurance firms, that might provide insurance services in combination with other services and products, including credit, such as personal loans. We note, for instance, that the proposed provision would not be applied to thrift holding companies, These potential competitive differences would be ameliorated by extending any tougher anti-tying provisions to thrift holding companies and by curtailing the ability of other businesses to acquire non-banks or consumer banks to which these provisions would not apply. Within that framework, I believe fair and reasonable procedural safeguards could be maintained.

The provisions of S. 2181 limit the scope of real estate development activities, while S. 2134 would not authorize such activities. We believe there is a reasonable middle course.

The term "real estate development" is itself an ambiguous and poorly defined activity, ranging in some concepts to including housing and commercial construction; speculative purchase of land; and owning, managing, and maintaining office buildings and other commercial properties. Taken as a whole, real estate development is an activity that experience has taught has large speculative elements; it is marked by cyclical instability, and the risks and large commitments potentially involved could bias lending decisions. As I understand it, however, the main concern of many banks interested in "real estate development" is taking more passive equity positions in projects managed by others, usually in connection with lending commitments, or to help facilitate the sale and exchange of property.

The Administration proposals provided some basic and desirable limitations on risk by confining investment in real estate development subsidiaries to five percent of holding company capital, and S. 2181 would rule out construction activity as well. We support those provisions, but also believe it might be desirable to adopt certain other limitations on the scope of real estate development activities. After further consultations with interested groups, we will be prepared to suggest more precise legislative language. In any event, we believe the Board should have clear authority to maintain minimum capital and maximum leveraging provisions for real estate subsidiaries in the interest of the stability of the institutions and the banking system.

Another provision of S. 2181 is responsive to the concerns expressed by some, including the Federal Reserve Board, about the possible potential for an excessive concentration of resources from a combination of banks and insurance or other non-banking companies within a holding company. Specifically, the bill provides that a holding company accounting for more than 0.3 percent of domestic deposits could not invest more than 25% of its capital in any one class of permissible nonbanking activities. I appreciate the ingenuity of the proposed approach. But I am both concerned about the arbitrary elements inherent in a double-barreled statistical test, and whether it would in fact effectively accomplish the stated purpose.

Preliminary analysis suggests, for instance, the largest bank holding companies could acquire controlling interests in the largest insurance companies. We are studying this matter further to see if in fact a simpler and more direct test may adequately achieve your purpose. The complication does not, of course, arise in the context of S. 2134, which would provide for no expansion of insurance powers.

One of the ways in which S. 2181 differs from the Administration proposal is in carving out a major exception to the general definition of a bank. The proposal raises technical and drafting problems, but I would like to focus today on the policy issues. S. 2181 would, in effect, legitimize the idea of a so-called "consumer bank" operating outside the framework of the Bank Holding Company Act. In effect, a class of banks concentrating primarily on consumer business would be established free from the general banking rules against conflicts of interest, concentration of resources, and assumption of undue risk. Moreover, while the proposal formally attempts to limit interstate acquisition of consumer banks, the provisions for exempting industrial banks from the Bank Holding Company Act would open an avenue for substantial undermining of the restrictions on interstate banking.

Thus, under the proposal, a bank holding company would be able to add interstate deposit-taking and other consumer services to the range of interstate business lending and other activities already permitted under the rubric of Edge Act affiliates, loan production offices, and finance companies. While we favor review and liberalization of restrictions on interstate banking, we believe that question should be approached directly on its own merits, and outside the context of the definition of the term "bank" that has such important implications for the policy objectives of the Bank Holding Company Act.

For nonbanking companies -- insurance companies, investment houses, retailers, and industrial firms -- the practical effect would be to provide direct access to the payments system and to facilities for offering insured deposits to the general public in conjunction with a range of credit services. Moreover, those non-banking companies would appear to be able to engage in the equivalent of interstate banking, at least through industrial banks, and probably through the ability of their nationwide office networks to act on behalf of consumer banks owned by these companies.

The overall result would be to provide commercial and investment firms major benefits of being a bank, while not subjecting them to rules applicable to banking institutions -- that is, limitations on the range of activities and ownership, and protections against conflicts of interest, concentration of resources, and excessive risk.

It has been suggested that these nonbank banks do not raise these public policy issues because they could not engage in the range of commercial lending that characterizes the activities of a typical commercial bank. I question whether this is a valid conclusion. Virtually the same issue was faced by the Congress in 1970 when it considered an exemption from bank holding company restrictions for small banks. It concluded then that ties between firms engaged in commercial and industrial activities and banks, even if those banks were to be engaged predominantly in consumer lending, raised serious problems because of potential conflicts, and could encourage increasing cartelization of our economy through the exercise of preferential lending.

Even more immediately, the proposed arrangement appears competitively unfair to established banks, undercutting the public policy objectives sought by the Bank Holding Company Act, by giving essential benefits of being a bank to those that are not subject to these rules. Any system based on this inequality of treatment will inevitably come under strain.

I would strongly suggest adoption of the definition of bank contained in S. 1609 and S. 2134. The definition contained in these bills seems to have a wide measure of support as evidenced by its inclusion not only in these two bills, but also in legislation proposed by Chairman St Germain, the FDIC, and by the Federal Reserve as well.

Earlier in my testimony, I mentioned the importance of an adequate definition of what is a thrift institution eligible for the special benefits provided by law for these institutions. S. 2181 suggests a dual test for thrift eligibility for treatment as a unitary savings and loan holding company -- 60% of assets in residential mortgages and mortgage-backed securities or no more than 25% of assets in certain qualifying commercial loans. The second alternative and independent test leaves open the possibility that institutions not engaged very substantially in home mortgage lending would retain liberal treatment with respect to activities and banking. For example, 75 percent of commercial banks could be treated as thrifts because they have less than 25 percent of their assets in qualifying commercial loans (only six commercial banks would qualify under the first test alone). If, however, the bill were modified to provide a true dual test -- i.e., both a minimum residential mortgage and a maximum business credit test -- I believe the real intent of this provision would be met. The point is that only firms truly committed to residential mortgages should be provided the existing benefits of unitary holding company treatment, and a single test of residential mortgage lending, as provided in S. 2134, should be adequate provided the percentage is sufficient, taking account of current federal limitations on commercial lending powers of thrifts.

Plainly, a problem would be posed by this approach for many savings banks which traditionally have had many securities in their portfolios but which wish to maintain a basic thrift orientation. Moreover, institutions with mutual ownership which fail the test would have difficulty in taking advantage of the full range of holding company powers that would be available to stock institutions.

A large part of the answer could be found in transitional arrangements extending over years; those arrangements could set out benchmarks for measuring progress toward the objective. In addition, the possibility of non-specialized mutual institutions exercising holding company-type powers through subsidiaries could be explored.

I also note that S. 2134 would limit tandem operations of a qualifying S&L with its non-banking owner; that is the joint offering of products and discounting to common customers would be discouraged. Those provisions seem to me important to maintain the separation of banking and commerce. The general prohibitions on bank holding companies underwriting corporate securities should be applicable to thrifts as well. The further question also arises as to the extent to which thrifts not eligible for unitary treatment should be afforded access to FHLBB credit.

Remaining Points

I will not at this time burden you with detailed comments on the remaining nine Titles of S. 2181. So far as two of those are concerned, I indicated our broad support for payment of interest on reserves and interest on demand deposits in my testimony last September.

Title X would authorize regional interstate banking compacts for a 5-year period. I previously expressed my concern about the Balkanization of the banking system implicit in regional compacts along what must inevitably be arbitrary lines. At the same time, some evolutionary easing of present state restrictions appears appropriate. While I believe there are more efficacious approaches than regional arrangements, we would not oppose Congressional authorization of regional compacts if viewed as a temporary and transitional matter. That, as I understand it, would be the purpose of the provisions of S. 2181.

We will be happy to submit detailed comments on the provisions about bankers' banks, consumer leasing, delayed availability, usury ceilings and credit card fraud at an early date.

Conclusion

I am convinced that all of the efforts to improve the legislative framework governing the financial system, taking account of the vast changes in the regulatory and technological environment for the conduct of banking, are now ready to bear fruit. The discussion and debate on new powers, new definitions and on competitive equity have been reflected in a "core" area of consensus, and the remaining issues are ripe for decision. Workable proposals and the necessary information are at hand.

The task is urgent. We still have an opportunity to shape the direction of the financial system in a manner that recognizes and accommodates market forces but also recognizes enduring concerns of public policy.

But we don't have unlimited time. Far from it. The present arrangements are in disarray, and events, willy-nilly, are forcing change that may, or may not, be consistent with considered judgments about the public interest.

We want competition, and the benefits to the consumer inherent in competition. We also want a safe and sound banking system, stable in itself, and contributing to a larger economic stability.

If we act -- and act promptly -- we can further both those aims. We want to cooperate with you actively in working toward that end.

The **Chairman**. Thank you very much, Mr. Chairman. I appreciate your comments and helpful suggestions. I would certainly agree with all of those issues contained in those various approaches; that there is a core that although there are some technical differences of opinion as you have pointed out, they are purely technical. It's a matter of how to handle it.

I am hopeful that during this year we can at least have an agreement with some of those core issues and some of the more controversial issues being put off. I just hope that we don't get them all tied together to the point that nothing takes place. So I appreciate you saying that because that is my feeling, and I think one of the things that we learned in the last process is that a lot of people who were afraid to talk to each other found they could. They had been competing against each other for years and they were able to come to a general consensus and produce a bill. I am hoping that same spirit will continue.

Now, in all of our meetings together over the last several years it has always been totally impossible when you appear before the Banking Committee to be able to confine your remarks only to the subject of the hearing, which is banking deregulation. It always occurs at some point in the hearing. So I thought I might just as well give you the opportunity to make your comments on the general condition of the economy, deficits, interest rates, monetary and fiscal policy at the outset.

When you have made those comments, which everybody is waiting for, then we will get back to the subject of the hearing.

Mr. **Volcker**. How soon is the Secretary of the Treasury going to be here; how long do I have?

The **Chairman**. His plane has been delayed.

Mr. **Volcker**. Let me just say—and I'll try to be brief about it—that we have just come through a year in which performance exceeded expectations in, I suppose, all the important directions. Sometimes we have a better economy than anticipated. Sometimes, more rarely, we have a lower inflation rate than has been anticipated. It is unusual to have more economic growth and less inflation at the same time.

I do think that happy news reflects or is consistent with, the feeling that I have that we have an opportunity now to see the economy develop in a constructive way over a considerable period of time. We were, in some respects, going downhill for a good many years due to the problems with inflation and the rate of growth and productivity declining, and unemployment tending to rise. Unemployment was moving cyclically, but over the trend of time, it was rising.

Now we'd like to see a set of years in front of us where all that can be reversed; it certainly was reversed in 1983.

Let's recognize that was a recovery period. It's easiest to grow during a recovery. We had a severe recession, high unemployment. In a sense the recovery period is over. We are back to higher levels of employment and output than when we started. We are now in the expansion phase, and we want to see if we can keep the expansion phase going.

HOPEFUL SIGNS TO CONTAIN INFLATION

An important element, in my thinking, is whether we can continue to contain inflation and continue that kind of progress. There are hopeful signs, not only in what we see happened last year in the price index figure released late last week. There was a 0.6-percent increase in wholesale prices for the year as a whole. That was the lowest figure since the mid 1960's. Wages have been rising less rapidly; that may not be seen as good from the viewpoint of the wage earner, but it is good in the price index. There is a lower rate of wage increase, but the real rate is increasing. That's possible, in part, because productivity seems to be rising again. But that's a long-term matter and I don't want to call victory, so to speak, on 1 year's productivity growth; it takes longer than that.

The news is pretty good. If we could maintain that kind of inflation record, it seems to me that the point that many people make, that interest rates are high relative to inflation, is true. Judging on past experience, they ought to come down, which helps the economy to grow and helps investment and housing.

As soon as we say that, we come to the fly in the ointment. We have an unprecedently large budget deficit, peacetime budget deficit, relative to the size of the economy. It is unprecedented in the sense that while we have had big deficits in the middle of recession they decreased very rapidly in the period of recovery and expansion. That is not happening currently, and it won't happen under current tax rates and spending programs.

I think that poses obvious risks—the most important risk to this happy picture we are trying to describe—because as the economy grows, the faster it grows the more private credit demands will be generated. As they are generated, our savings capacity is limited, our capacity to increase the supply of credit is limited.

If we want to deal with inflation, Government preempts, and will continue to preempt, a great deal of this credit, so what are the implications for housing and for business investment?

The CHAIRMAN. Let me interrupt you there, too, because I share your opinion of the economy. It has surprised me the growth and recovery that we have seen. But to those who understand the difficulties of the deficits, they will, in my opinion and as you indicated, choke off in recovery. We are still slack in the economy. But to indicate what you said about the credit crunch, I want everybody here to know that if we continue with those $200 billion deficits, we are talking about the Federal Government borrowing more than 70 percent of the net savings of this country to finance only the Federal Government.

Now, I don't care whether people are liberal or conservative, Republican or Democrat, I can't accept the fact that anybody believes, regardless of political philosophy, that we can have the Government borrowing more than 70 percent as an acceptable level. That takes money away from automobile loans, from consumer loans, from housing mortgage loans, from venture capital, from investment in new plants and equipment. That has to crowd out money available for the private sector, drive up the price of money, and bring back inflation.

So I wanted to amplify what you said about the negative side of your positive statement about the economy. We are all pleased about it.

BORROWING MONEY ABROAD

Mr. VOLCKER. Let me carry your point one step further. As you pointed out, the Federal Government deficit is taking two-thirds to three-quarters, in even optimistic projections, of net domestic savings. What we are doing is borrowing money abroad. We are supplementing our domestic savings by borrowing an amount that may approach or exceed 2 percent from abroad. It keeps the interest rates lower than they otherwise would be. It's nice as long as it lasts. But that can only be done at the expense of the other sector of the economy, namely exporters or those competing with the importers.

Our current account is moving into deficit. It seems an almost unbelievable figure, but it may be $80 billion in 1984. There are the direct effects on the economy from the deficit. People depending on those industries are wondering about the question of the sustainability of that phenomenon. It isn't sustainable indefinitely. There are other factors involved, including the fact that our economy is growing faster than the economies abroad. It helps the other economies expand, but there is an element in it of excessive reliance on foreign capital to, in effect, indirectly finance, and sometimes directly finance, our deficit.

It also aggravates another problem in an international area that I think we have to be concerned and cautious about. Among the happy news there are great strains continuing in the international situation. The stability of those countries, the stability and viability of those debts, the countries all around the world that are heavily committed to lending—all of this is a continuing problem and will require continuing efforts on the international financial front.

I don't minimize the challenges in front of you, but I do think that we have a better platform now for moving ahead with economic growth and with stability than we have had, I'm tempted to say, almost within memory. Those problems that we have are so very real and very well known. I would hope that being known they can be dealt with in time.

I don't expect miracles this year but I do think we need to begin to make progress and deal with this deficit problem effectively.

Senator LAUTENBERG. Mr. Chairman, are we going to hear rebuttal when Secretary Regan gets here? I'm just curious?

The CHAIRMAN. I will be happy to ask Secretary Regan his opinion. He knows I disagree with his opinion of the deficits. He knows, and it's not new.

Senator LAUTENBERG. It will be fun.

The CHAIRMAN. Let me return now to the bill, Mr. Chairman, and ask you a specific question. You propose to include industrial loan corporations within the definition of the bank under the Bank Holding Company Act and we are concerned about the interstate implications of that.

Later this morning or this afternoon in testimony Elaine Weis, who is our commissioner in the department of financial institutions in Utah, concludes that, and I quote, "That would have significant negative impact on Utah financial industry."

In particular she is in opposition because many owners of Utah industrial loan companies would be forced to divest those subdivisions of their businesses after many, many years of responsible operation. We have had some very fine industrial loan companies in Utah.

How would you respond to her criticism or comment about the industrial loan corporation?

Mr. VOLCKER. I would be delighted to have a chance to understand her specific concerns later.

The CHAIRMAN. We will make certain that you do.

Mr. VOLCKER. Let me say that industrial loan companies could continue to operate under the kind of approach that we have seen, in the way in which they have operated traditionally for many years, if they don't take demand deposits or the equivalent of demand deposits. I think they would find that they would be able to continue to operate in the same way.

If they introduce NOW accounts, which is a relatively recent phenomenon, they could continue to operate as well. They would be restricted as to whom they could loan, that is true. You have to ask the consequences of opening up this class of institution to basically unlimited ownership if they can exercise both sides of the banking powers, in effect. That's what concerns us.

In Utah you have an exception which looked small originally and would be small, I think. Industrial loan companies have some importance in Utah but even in Utah they are not obviously the principal financial institutions by a very long shot. You opened up special arrangements for institutions of this sort, and you ended up undercutting precisely what you were trying to deal with, because you can be sure they are going to be used more and more if they are the ones granted exceptions.

The CHAIRMAN. Obviously we will enter, over the next few months, a more detailed discussion of this issue. But we will make you and your staff aware of Commissioner Weis' testimony so you can have the benefit of her thinking and impact not only of her opinion but other States that have similar arrangements.

Senator Gorton.

MAINTAINING REGULATORY JURISDICTION OVER BANK HOLDING COMPANIES

Senator GORTON. Mr. Volcker, you have criticized, both today and in earlier testimony, proposals to reduce the Federal Reserve Board's regulatory authorities, not recognizing the relationship between bank activities regulation and the conduct of regulatory policy. Could you illustrate, by example, as to how the Board's ability to conduct monetary policy would be weakened if they do not retain regulatory jurisdiction over bank holding companies?

Mr. VOLCKER. Let me put it in perhaps more black and white terms than the situation justifies and give you a number of examples.

One you can see conceptually. Suppose the Federal Reserve Board has no banking or holding company supervision. We are responsible for monetary policy. Suppose banking regulators removed from the Federal Reserve—for what may be a straightforward reason in their mind—impose capital, or liquidity, or provisionary requirements on banks that have the practical effect of greatly diminishing the ability of banks to grow and make loans at any particular period of time. Suppose that happened to coincide with a period where, from a standpoint of monetary policy, you wanted to see some expansion and loan growth and bank asset growth. You would have a problem. You would have a potential conflict that had to be resolved.

You can see the other side of that coin. Suppose, for whatever reason, capital reserves were eroding and liquidity was eroding; and perhaps, for good and justifiable reasons from a particular regulator's perspective, that development were permitted to continue and were not particularly restrained. We would run then into a tight money period because the Federal Reserve would feel it must take fairly aggressive steps to curtail expansion. Do we have a strong enough system to withstand the strain of that monetary policy?

Marriner Eccles was concerned in the 1930's with a different aspect of this problem. He was concerned, during that period in the middle of the Depression when he was starting to encourage expansion of banking and growth of banks and particularly credit extension, that bank examiners were overly reactive to the experience of the 1920's and early 1930's and were, in effect, discouraging banks from making new loans and discouraging the new plan he, Eccles, had in mind. He expressed great concern in that period that there wasn't enough coordination between the bank examination process and monetary policy process, even though the Federal Reserve itself had responsibility for examining banks and did in the 1930's.

More recently, we have seen instances of the potential problems in this international loan situation. It involves very difficult questions where a number of different perspectives have to be resolved in connection with reserve provisions, disclosure provisions, and also the necessity of carrying out programs with those countries that may involve new loans to make it possible for them to make the adjustments that are necessary. How do all those things get resolved?

I think the Federal Reserve needs a large voice in that process and that it would be dangerous to insulate the other questions from the kind of questions with which we have to deal.

Senator GORTON. Would it be sufficient if the Federal Reserve Board retained jurisdiction over the 25 or 30 largest holding companies?

Mr. VOLCKER. You would have a good percentage of the holding company assets, but a lot of other questions arise when you want to confine the Federal Reserve to that particular group of banks. What's the difference between the 26th bank and the 25th? There are quite a lot of arbitrary elements.

Let me say, Senator, that all those questions are under intense consideration by the Bush task group and various combinations are being considered right now. We will see, literally within the next few days, whether we can come up with a kind of proposal that balances out, as best we can, all of those considerations.

REDEFINITION OF COMMERCIAL LENDING

Senator GORTON. On another related subject on which you commented at least indirectly and perhaps directly during your original testimony, the Fed's redefinition of commercial lending in regulation Y runs counter to the bill which Senator Garn has set forth.

Can you tell me what motivated the Fed's recent redefinition in regulation Y, and the impacts of that, and restate your opinion of a limited commercial lending power to nonbank banks?

Mr. VOLCKER. We are operating within the context of present law. I would preface my response to your question by saying we urgently desire that you get the law rewritten so this can be done within the framework of a refreshed legislative direction. We rewrote the definition—more accurately, in this round, we codified an approach that we had adopted sometime ago, in August—in a way that was within what we could do with existing law and we think is consistent with the proposals in the Treasury bill, the proposals in Senator Proxmire's bill, and the proposals in Senator Garn's bill, except for this consumer bank and industrial bank exemptions.

We think this is necessary to accomplish the purposes of the Holding Company Act which was to set forth this separation between banking and commerce. What the Congress had in mind and our best reading of the legislative intent was to interpret the law to maintain that separation.

What has happened is that increasingly people have exploited what was thought to be a small loophole when the Holding Company Act was passed in the particular interest of a couple of concerns not doing a real banking business but with some banking powers. As that loophole has been widened, we have attempted to narrow it.

We believe that if we had not done this, your direction, in effect, would have been preempted; the ground would have been won by those who wanted to enter into banking through this loophole before you had had a chance to act.

This question of industrial loan companies in Utah that was just raised would be a very small question at that point; the whole battlefield would be strewn with bodies had the loophole not been narrowed. Se we believe we were clearly operating within the intent of the Congress in passing the Holding Company Act.

Senator GORTON. Nothing in my question was meant to indicate any other view toward that. My question was soliciting your policy views of the direction in which we should go. That direction——

Mr. VOLCKER. This is not the best way to do it. Our action is with respect to thrifts, which are important given thrifts' new powers. Where we stand now, with our new regulation Y, is not a satisfactory position. It is all we could do within the context of present law, but I think it is consistent with the policy recommendation that I am making and that is to redefine a bank, an institution eligible for deposit insurance and operating as part of the payment system and the rest, and start afresh with a reasonable definition.

UNLIKELY MAJOR CHANGES IN POLICIES TOWARD DEFICITS

Senator **Gorton**. Now if I may, Mr. Chairman, change directions once again and follow up on one of the general economic questions of Chairman Garn. You indicated, in passing, that it seemed relatively unlikely that major changes in policies toward deficits were likely in calendar year 1984. Does that indicate, Mr. Chairman, that it is your view that we can safely let the 1984 year and the election go by before we take serious and systematic approaches toward reducing budget deficits or do you feel that we endanger the economy by doing so and should deal with this problem promptly, election or not?

Mr. **Volcker**. I believe you should deal with this problem just as promptly as you can. I don't think the economies and markets wait for elections. The way I would put the issue is that the risks to the financial market and the risks to the economy become greater as time passes. Nobody can predict for you whether there will be a great problem in 1984 or whether it will conveniently wait until after 1985, after an election.

From my observations, I don't know why it is so much easier to act after the election than before, in some respects. I do feel very strongly that the risks get greater and greater. If we are lucky, what will happen is that housing will be less than it otherwise would be; interest rates will be higher than they otherwise would be; business investment won't be as strong as we would like to see it; and it will have adverse effects on productivity down the road. But we will continue to get a flow of foreign capital and for a while nothing dramatic will happen. That's not very good, but that's the good news when the situation is left untended.

The bad news would be that the risks materialize in pressures on the credit market and pressures in the exchange market of a kind that would be very difficult to manage against a background of a continuing deficit.

I did not mean to say that there should not be large political steps, if that's the word I used. I may recognize that there are not going to be very large—as large as I would like to see them—actual steps to reduce the deficit in the course of 1984. We only have 11 months and you have to pass new laws. But I think it is very important that you begin taking steps in the context of a longer range policy that would be of adequate size, and that the sooner that can be put in place the sooner those risks can be dissipated. They would be dissipated to a substantial degree by a policy beginning as soon as you can, but moving over a period of time in a forceful direction.

Senator **Gorton**. Mr. Chairman, I have been handed a card that my time has expired.

The **Chairman**. I'll follow very briefly before I turn to Senator Lautenberg.

On the question of doing things before and after an election, I think the Congress should recognize that we are always before an election. As soon as the 1984 election is over they start thinking about the 1986, and that is probably why we have $1,400 billion deficit is because we are always before an election. So it seems to me 1984 is as good a year to act as 1985, particularly with the

House of Representatives. They have to start their reelection the day after the previous election.

Senator LAUTENBERG. You seem to be more comfortable when you have a 6-year term.

The CHAIRMAN. I'm talking about 1986. I'm up then.

Senator LAUTENBERG. As usual, it's a treat, Mr. Chairman, to hear your comments.

I am fearful that the chairman opened the gate by enabling us to get off the subject, perhaps for a few moments, of the banking regulation and the new laws interested in the concerns of the economy.

I would like to make this comment: You have never been shy. You say the same thing in Utah as you would in Washington or New Jersey. You have been blamed for the severity of the recession but I haven't heard you get credit for the bouyancy of the recovery. I don't know if that has to do with politics.

In any event, what I am concerned about and I expressed it earlier, was what happens to the individual who needs local service and might make particular efforts in this State such as the small farmer, or businessman, or the individual? You said earlier that you favor national banking lines and I was pleased to hear Chairman Garn's concern about your comment on transitional banking, from regional to national. It's quite obvious to those of us from the States of Washington, Utah, and New Jersey that if there are national banking companies, it's not likely that any one is going to be headquartered in any of the States that we represent. I think that kind of takes away the local involvement and the opportunity to influence policy.

You are concerned about concentration and too few hands. You expressed yourself on the 25 or so largest bank holding companies. You didn't include in your comments, however, the danger of regional concentration of economic financial power, unless I missed it.

Would you comment on that?

Mr. VOLCKER. Let me say the point you raise is one of the concerns I have about these regional arrangements. You don't necessarily get a better result by a lot of concentration within a region. You might have more diversity of credit outlets, more competition by allowing a wider geographic range for institutions to enter.

STATE BANKING LINES ARE BEING OVERRUN

Let me say, in terms of moving toward nationwide banking, I am not, by any means, proposing or in favor at this time of an immediate move, or prompt move, or an eventual move toward complete interstate banking. But I think with today's technology the State banking lines have gotten increasingly arbitrary. In fact, they are overrun every day by the forces of of the marketplace. I think we could have a more orderly system by some movement in that direction.

There are important questions about what kind of an approach to take, recognizing most of all the kinds of concerns that you and Senator Garn both emphasize.

I think there is a good deal of evidence that small banks can survive and will survive and can be healthy, particularly if you do some of the other things in this banking legislation to maintain the basic distinctions between banking incumbents. But just how the question is approached—and it's an extremely controversial question—needs a lot of consideration.

All I am attempting to say is from where we are, our State lines as drawn in all instances don't give us the best results, even in terms of the valid concerns you have.

Senator LAUTENBERG. Your comment about the fact that there is a place for the small bank reminds me of the endangered species with the hunters out there. When you look at the numbers of mergers that have taken place and the accelerated pace of that—certainly in my own State we have had a high number of that—individual ownership banks have been reduced substantially and obviously the trend continues that way.

The thing that I was concerned about further is the abuses that we have seen that take place as a result of legislation in South Dakota, that permit insurance sales to be conducted outside the State. I'm not sure that Senator Garn's bill deals adequately with that. Do you?

Mr. VOLCKER. We believe that the legislation should deal with that situation. There are several avenues that could be taken. There are at least two proposals on the table now. I think we cannot permit the proposal that allows a State to do that and, in effect, provides for somebody to go into business outside its own borders.

There's another approach that says you can give the State some discretion for activities within the State that is a still more direct approach.

Another approach would be to define a broader circle, so to speak, within which States could exercise some discretion. But there may be some things that are beyond the pale from the standpoint of national policy. There are a variety of techniques that could be looked at.

The principal point I would make is that I think it should be looked at and that appropriate limitations be included in new legislation.

Senator LAUTENBERG. The thing that concerns me with respect to my colleague and friend and chairman who has worked very hard on banking law and has a record that I respect in this area, I come into the Senate not particularly with banking background. However, my company, I think you know, Mr. Chairman, was one of those in the forefront of technology that enabled banks to do any business anywhere in the ATM, automatic teller machine. I no longer have interest in that company, I point out.

But the fact is, as a coincidence of that I noticed an ad in the New York Times running on several different days. It was a full-page ad advertising something called payroll and processing service. And again, I hope that we would be able to divorce the former Lautenberg from the present Senator Lautenberg because the payroll service was a big part of the business that enabled me to achieve the ability to finance an election campaign and get into the Senate.

But the ad was by Bank of America and it said that "Managistics, their newly acquired division, is where people should go to have their payrolls processed because Managistics was a division of one of the most important banks in the country," having precious little to do with their ability to service their business or to offer any kind of specific advantage.

I am not concerned about ADP. They will compete in the marketplace. I left a wonderful team behind me. But I think it is that kind of a thing that is the indication.

I don't want to pick on anybody, but it is that kind of thing that worries me about the process of tie-in, whether it has to do with a retail company owning the financial institution but protected by the AIC that says if you take your mortgage loan here you'll get your furniture at a discount and other services. That scares me because I am still wrestling with the vision of what new banking law ought to be.

Mr. Chairman, whether or not it ultimately results in the best service for the individual, for the borrower, for the depositor, is its reason to enhance the profitability of the banks in the country who don't seem to be suffering, very frankly, based on the changes that have already taken place. If you look at the results for 1982 you will see that the profitability for banks has returned to the same level it did for the period of 1970 to 1979.

I look at new banking law and want to participate in that development as having the obligation of rendering the best service to the community at large. I just wonder without having to make too long of speech, Mr. Chairman, whether you think that is gong to happen?

Mr. VOLCKER. I suppose my response is you have to make precisely those kind of judgments. Where do you draw that line? We are urgently requesting some guidance from you. From my standpoint, I think activities engaged in by the same holding company are going to have some of the aura you suggest whatever direction we go in.

"You deal with me here. I am part of a larger organization." That may have some kind of implication either for the strength of my services, the prestige of my organization, the possibility of contacts elsewhere in the organization. Some of that is going to be there. You can limit it, and I think it's appropriate to limit it, as existing law does. Senator Garn goes further.

This becomes a matter of judgment. If this is such an important concern in some areas, at some point you must say that is an area in which a bank or a bank holding company should not be engaged. The kinds of problems you foresee have identifiable, deleterious effects. In other cases, in many cases, the result may be more competition. I think the result will usually be more competition. You have to balance the tendency to get more competition against the kind of concerns that arises when you have the power or the prestige or influence of the holding organization brought to bear across particular lines.

Where are the appropriate limitations? In general terms the traditions of the country answer that question. When you are in the financial area, when you are in areas relating to banking, the benefits are going to outweigh the disadvantages. When you get out into linkages with commercial services and with some types of investment services, we are inclined to say "no". That's easy for me to say. But you ask me to draw the precise dividing line, for data processing services or payroll services——

Senator LAUTENBERG. No, I'm not asking for that. I just want the record to show that——

Mr. VOLCKER. Or any other services such as real estate brokerage or insurance services. Those are important areas and we clearly need guidance, because those questions are going to arise about those important services. Do the competitive advantages outweigh what you might think of as the residual risks?

The tie-in doesn't have to be at all nefarious. In some cases it may be overdone, but there may be some synergism in connecting some of those things. Is that good or bad in terms of the competitor who has to stand on his own feet?

I guess I expounded enough philosophy without giving you a very specific answer, but those are precisely the areas at issue. You make those gross judgments when you decide whether the holding company can do insurance or not, or what types of insurance it can do. There are arguments on both sides of the issue.

We have supported that. We support real estate brokerage. I might say there is a lot of legislative work to be done even if you didn't touch those questions which are the more controversial.

I want to see you touch them; I don't want to be misunderstood. But I do think if any one of those particular areas becomes so difficult, or there just is no consensus, there are a lot of other things to be done.

The CHAIRMAN. Well, this last discussion has hit on a number of problems. Where do you start drawing the line? That's what all the hearings and process has been about, to see if we can arrive at this consensus.

But I am particularly grateful for the distinguished Senator from New Jersey in admitting some of his guilt in helping cause this problem with his suggestion in the business field and the great sofeware computer business that allowed banks to do this. This gives him a special responsibility now as a member of the committee to help us solve the problem.

Just like Secretary Regan. I've told him the same thing when we address the problem of money market accounts in Merrill Lynch, which he invented. It took all the money out of the State and local and depository institutions. As Secretary of the Treasury, he has a special responsibility to help us solve the problem. So I am going to rely on Frank a great deal in determining where the line should be with his great success.

Mr. LAUTENBERG. I'd like to help. I want to help the consumer. I wonder whether we need legislation specifically against tie-ins?

Mr. VOLCKER. I want to point out the kind of phenomenon referred to also takes place when a bank is not involved. It takes place in a Sears Roebuck where you have a retailer, an insurance company, and investment house—even forgetting about the savings and loan—and there is opportunity for cross tallying and all the rest. I suppose, in a way, you would say the presumption in the financial area is that a bank holding company could do it unless the kinds of concerns you have in a particular instance outweigh the presumption.

The **Chairman**. Well, to follow this a little further, we are concerned about concentration not only in bank holding companies but in other financial industry as well. Most of the talk is about the banks. But there's big insurance companies and security firms.

One of the biggest objections raised by those who are concerned with broader bank holding company powers is that banks have marketplace leverage. Every time I bring this up you say, "Well, Merrill Lynch or Sears or whoever does. But we are not in this business. We don't have this leverage on loan decisions." That is always their justification for getting into CMA or bank-like activities, because they don't have that leverage. And this hurts, of course, the purchasers or insurance and securities and other products, real estate, and so on.

What extent do you believe that those conditions of these changes would provide banking organizations with an unfair competitive advantage over the other types of institutions?

Mr. **Volcker**. I suppose my answer is that in those areas that we have talked about and have supported, our feeling is that it will not have that result. Just as I think the smaller banks can, in many cases, survive in competition with bigger banks because they are smaller and more flexible, I think there is a place for a specialized institution and, indeed, I think in many cases the specialized institution will operate more effectively than the conglomerate and the marketplace will sort that out.

I do think, in general, if you have to write extremely burdensome rules, that raises the basic logic in doing this at all. Either on the side of concentration, or on the side of tying, I think at some point you may want to say "no."

But, in the areas that we have described, we certainly feel prepared to go ahead with a limitation on concentration of the largest banks and insurance companies as you have addressed in your bill. We have a question whether that's the right formula; I think it is a concern that you properly addressed.

The **Chairman**. I have no pride in authorship in that particular form. But not only in the commercial bank or bank holding companies, but to eliminate large concentration in the very biggest financial institutions in this country regardless of what they are.

Mr. **Volcker**. It's easier to say that there are deficiencies in your formula than to give you another formula with fewer deficiencies. When it becomes impossible to make a sensible formula, you wonder whether you should do it at all.

The **Chairman**. Mr. Chairman, we have a large number of additional questions, and as usual we have appreciated the opportunity of listening to you. We have been here an hour and a half. As the months progress we will have you back before the committee to respond in more specific detail to the provisions and make recommendations to formulas and things of that nature so we can make that comparison.

Secretary Regan has arrived. Western has delivered him. But Senator Lautenberg has——

Senator **Lautenberg**. I'll pass, thank you.

The CHAIRMAN. But we do appreciate your extra effort, particularly with our large piles of snow. I would note, before we release you from the witness table, how much more roomy this hearing is than the hearing room in the Dirkson Office Building; how many more people under much more comfortable circumstances we can accommodate. This is twice as big as the one we had to deal with where we had people hanging from the chandeliers and sitting in the window wells to hear people from the Banking Committee. The Salt Palace has served us well.

Senator LAUTENBERG. You are not suggesting we consider it permanently?

The CHAIRMAN. I am suggesting we hold more hearings out here, but I would not destroy Utah by bringing Washington here.

Senator LAUTENBERG. Well, we would welcome you to New Jersey.

The CHAIRMAN. Washington is 2,300 miles away and that is maybe not even far enough.

Mr. VOLCKER. We appreciate the chance to visit with you out here in the great West. It's a welcome change of scenery and view. Next time the Sun will be shining, maybe.

[Whereupon, a short recess was taken.]

The CHAIRMAN. Mr. Secretary, we deeply appreciate—particularly knowing how busy your schedule is in Washington—that you would take the time before the Banking Committee here in Salt Lake City. So rather than waste any more of your time, we will proceed to your testimony.

STATEMENT OF DONALD T. REGAN, SECRETARY OF THE TREASURY

Mr. REGAN. Thank you, Mr. Chairman.

[Prepared statement of Donald T. Regan follows:]

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

EMBARGOED FOR RELEASE UPON DELIVERY
Expected at 10:30 MST
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TESTIMONY OF THE HONORABLE DONALD T. REGAN
SECRETARY OF THE TREASURY
BEFORE THE SENATE COMMITTEE ON
BANKING, HOUSING AND URBAN AFFAIRS
SALT LAKE CITY, UTAH
MONDAY, JANUARY 16, 1983

Mr. Chairman and members of this distinguished committee:

I appreciate this opportunity to join you in Salt Lake City and to participate in this first of the 1984 Congressional deliberations on the future of the financial services industry in this country.

Mr. Chairman, you are to be applauded for your efforts on the important issue of financial deregulation and for your timely response to an urgent situation. The Garn-St Germain Depository Institutions Deregulation Act, which your leadership made possible, was an important step toward deregulation of the financial service industry. We are here today to consider that next step towards a more competitive and productive financial marketplace.

However, before I begin my testimony, I would like to make a few brief observations on our rapidly recoverying economy, if I may.

ECONOMIC OUTLOOK

Four years ago, this country was saddled with low productivity growth and high inflation. Real economic growth activity had virtually ground to a stand still. Today we see quite a different picture.

Inflation, as measured by the GNP deflator, rose by an estimated 4.1 percent over the 4 quarters of 1983 -- the smallest increase in more than a decade. For 1984, the increase is projected to be 5.0 percent.

Real GNP growth has been restored to a strong, positive track. The 9.7 percent annual rate increase in the second quarter was the largest since 1978 and was followed by a 7.6 percent gain in the third quarter. The initial indication is that real growth for 1983 was a strong 6.1 percent, measured fourth-quarter to fourth-quarter, and real GNP growth is projected at 4.5 percent between the fourth quarter of 1983 and the fourth quarter of 1984.

For 1985 through 1988, we have projected real GNP to grow at about 4.0 percent annually.

These growth rates should assure a substantial drop in unemployment, the true indicator of recovery. Because of the unexpectedly sharp plunge in unemployment in recent months, the employment rate for 1984 is now projected at 7.8 percent and, therefore, 1.1 percentage point below the 8.9 percent projected in the review we made in July, the midsession review.

Over the course of 1983, our strengthening economy put 4 million more people into jobs.

Additionally, business and industry plan to boost spending on new plants and equipment by a strong 9.4 percent in 1984. This should provide even more additions to American payrolls.

We see further good news in the area of interest rates. Interest rates have dropped from their all-time high of 21-1/2 percent in late 1980 to 11 percent currently, and we believe they should trend lower this year, and in the years ahead.

Clearly a growing optimism reflects widespread recognition that investment fundamentals are better that they've been in over a decade. And this is precisely why I wanted to discuss the recoverying economy at a hearing on financial service deregulation. The climate is right, the marketplace is poised, and there could be no better, nor more appropriate time for Congress to consider this issue.

To quote historian Carl Becker: "The primary aim of all government regulation of the economic life of the community should be, not to supercede the system of private economic enterprise, but to make it work." We are determined today and in the months ahead to "make it work."

PREFACE

Your proposal, Mr. Chairman, the "Financial Services Competitive Equity Act" represents a comprehensive approach to the issue. The passage of the Garn Bill would significantly benefit consumers, as well as providers, of financial services.

I would like to limit my remarks today to an overview of the issues we believe are most significant and the principal differences between pending proposals and the Administration's "Financial Institutions Deregulation Act" or FIDA. I have submitted, and you have before you, a more detailed statement.

NEED FOR NEW FINANCIAL DEREGULATION LEGISLATION

The most widely used description of financial industry regulation today is that of a "crumbling wall." Indeed traditional barriers between banking, insurance, securities and thrift institutions are rapidly becoming non-existent. But is that necessarily a bad thing? Are Glass-Steagall or McFadden and Douglas, for example, still necessary given the context of today's automated society? Those are just some of the questions that we will all be wrestling with in the days and months ahead.

FIDA, like the other proposals on the table before you, was born out of a need to simultaneously foster and channel the marketplace's competitive instincts.

The range of direct competitors to banks and thrifts has increased dramatically in recent years. The ability of the unregulated financial services firms to respond innovatively and rapidly to market changes has blurred the distinction between traditional banking and non-banking services. Consider the well-documented examples of such non-banking firms as Sears-Roebuck, Merrill Lynch, Shearson/American Express, and Prudential-Bache which are rapidly approaching the day when they will be financial supermarkets.

These non-banking firms, which are not subject to regulation restricting their activities, are applying increased pressure on our traditional depository institutions, by soliciting the institutions' more attractive and profitable business for themselves. This increased competition is reducing the depositories' revenues and their profit margins. In addition to decreasing revenues, depository institutions are also faced with a less-regulated, and therefore more costly, market for deposit funds.

The combination of these two factors -- increasing costs and decreasing revenues -- is exerting pressure on net interest margins.

Consequently, these institutions are forced to seek out supplements for their old businesses, based on costly "brick-and-mortar" branches. They are attempting to broaden their product lines, especially into securities and insurance activities, in order to remain competitive, but find their hands tied by outdated and unnecessary regulation.

And what about the consumers of today? They are much more sophisticated than the consumers of a decade ago. They demand, and expect to receive, major benefits from a more innovative and responsive financial services marketplace. The question is the supermarket versus the corner grocery store. The answer is: Both can and will survive in a competitive, deregulated environment; in a free market both will find an appropriate niche.

Only as more firms are able to offer consumers a wider variety of financial products at competitively lower prices and with greater convenience, will their new needs be satisfied.

To illustrate this point, let me cite a few examples of instances where financial product deregulation has benefited consumers through decreased costs.

First, depository institutions are rapidly becoming a major factor in the discount brokerage business -- brokers which offer their retail customers the lowest commission rates on broker transactions. Customers will clearly benefit as this efficient form of buying and selling securities becomes more readily available.

And, in the insurance field, we see one of the more inexpensive and convenient forms of life insurance on the market today, offered by mutual savings banks in New York, Connecticut and Massachusetts.

Let me emphasize: The Administration believes that product deregulation, such as the service powers of financial institutions and their holding companies, must receive priority consideration by Congress. Once this issue has been appropriately addressed, then the question of regulatory structure and regulatory responsibility -- currently under study by a Task Group chaired by Vice President Bush -- should become the subject of serious Congressional attention.

ADMINISTRATION POSITION ON S. 2181 AND S. 2134

Turning, then, to the issue at hand, I would like to first commend both Chairman Garn and Senator Proxmire on their respective bills, S. 2181 and S. 2134, to deregulate depository institution holding companies. Both proposals go a long way toward focusing the debate on this important issue. Only through debate and discussion can there come compromise, consensus and -- eventually -- legislation we can all live with.

However, of the two proposals, the Administration is supportive, in general, of Sen. Garn's S. 2181 as the more appropriate approach to financial industry deregulation.

FIDA and S. 2134

S. 2134, introduced by Senator Proxmire, is similar to FIDA in that it adopts FIDA's holding company approach to the deregulation of depository institutions.

We are pleased Senator Proxmire recognizes this structure for we are committed to the need to expand services through a holding company, not the depository institution. However, we feel that S. 2134 is too limited in scope and does not go far enough toward enhancing the ability of depository institutions to compete in the modern financial world.

Specifically, the bill would only authorize securities activities for bank holding companies, and would not authorize them to engage in insurance or real estate activities or activities determined to be "of a financial nature." By omitting these activities, S. 2134 fails to provide a regulatory framework to allow banks to keep pace with a rapidly changing financial environment.

Furthermore, S. 2134 continues to permit broader thrift service corporation powers, thereby encouraging the competitive inequality that exists between banks and thrifts. We would prefer to support a more comprehensive proposal, such as S. 2181, that creates a "level playing field" for the financial services industry.

FIDA and S. 2181

The Administration supports the overall thrust of the Garn Bill as a substitute for FIDA. Title I of that bill is based on the Administration's FIDA proposal.

Its major provisions would substantially deregulate the range of financial services that can be offered by depository institution holding companies -- largely along the lines of FIDA. We fully support the expansion of holding company activities provided in this bill.

There are, however, a number of important differences between Title I and FIDA. The more significant of these differences involve:

1) An exemption from activities restrictions for a unitary savings and loan holding company; the subsidiary of which is a "qualified thrift lender;"

2) A provision which specifically authorizes a "non-bank" bank -- a "consumer bank;"

3) A limitation on the size of combinations of holding companies and other financial intermediaries; and, finally,

4) Stronger anti-tying provisions of the Bank Holding Company Act.

"Qualified Thrift Lender"

The Administration is prepared to support, with appropriate modifications, the provision in the Garn bill for a "qualified thrift lender" which could be owned by any kind of firm, even though this represents a significant change from FIDA.

We are concerned, however, that the exemption be kept as narrow as possible to avoid abuse and essentially be tied, quite tightly, to residential real estate lending. In this respect, we would recommend that the only thrifts to be considered qualified thrift lenders be those that have only a very small portion of their assets invested in non-residential real estate loans, and that this be the only way to qualify for qualified thrift lender status.

In addition, we recognize that mutual savings banks are, historically, sufficiently unique as to justify a different "test." We would recommend that in order for these thrifts to be qualified thrift lenders, they should eventually be required to have the same percent of their loans in residential real estate as savings and loans, but should be given a generous time period to reach that required level.

Consumer Banks

Perhaps the most intriguing element of the Garn bill is the concept of a "consumer bank."

FIDA, through its definition of a bank, would have closed the non-bank bank loophole by subjecting any company that owns a Federally-insured bank to the BHCA. The Garn bill, on the other hand, uses essentially the same definition of a bank, but specifically excludes from this definition a "consumer bank." The Garn bill defines a consumer bank in general to mean a bank that does not make commercial loans.

As a result, securities firms, finance companies, and many others could enter the banking business by purchasing a consumer bank, yet would not be subject to the limitations of the Bank Holding Company Act.

Thus while FIDA would have closed the loophole completely, the Garn bill explicitly leaves it open.

The Administration has not yet taken a final position on the consumer bank issue.

There is some appeal to any approach which eliminates regulation at the holding company level, and this would be the effect of the consumer bank proposal, were it ultimately adopted.

Accordingly, we support continued debate and discussion of the advantages of the consumer bank as well as further specification of difficulties in its operational scope and potential restrictions.

Anti-Tying Provisions

We note that the Garn bill includes stronger anti-tying provisions than those contained in FIDA. While the problem of potential tie-in arrangements was addressed in the Administration's bill, many affected parties have argued that stricter measures are required. Taking these arguments into account, the Adminstration endorses the Garn bill's stronger anti-tying language for all depository institutions, including thrifts and consumer banks.

Size Limitations

On the subject of size limitations, FIDA authorizes bank holding companies to acquire, without size limitations, any company engaged in insurance, securities, real estate, except for a five (5) percent of capital limitation, or other permissible non-bank activities.

Likewise, the Garn bill authorizes holding companies to engage in these activities but prohibits combinations between depository institutions with three-tenths of one percent of U.S. domestic deposits and a company or companies engaged in these activities if the resulting holding company has an investment in any one such activity that exceed 25 percent of the company's consolidated capital. We understand this would affect approximately the 25 largest banks.

The Administration is not convinced that "bigness is badness," or that current anti-trust laws are inadequate. Therefore, we do not support any restrictions on institutions' size other than those under existing anti-trust provisions.

OTHER ISSUES IN THE GARN BILL

Again, I remind you that you have before you my written statement which goes into greater detail on each of the additional sections of Senator Garn's proposal, but I would like to touch very briefly on several specific issues.

Interest on Demand Deposits

The Administration supports the payment of interest on demand deposits and has provided legislation on this subject.

We do however, believe that demand deposit deregulation should be viewed within the context of a commitment to more comprehensive product deregulation. That is in the context of all of the deregulatory provisions of the Garn bill.

As I discussed earlier, the deregulation of deposit liabilities puts increasing pressure on a bank's net interest margin, and product expansion will become progressively more important to the economic well-being of bank and thrift organizations.

Interstate Banking

The question of interstate banking has been an important and controversial one facing policymakers for many years.

We are especially pleased to see that a number of concrete proposals have been introduced to address this question. In addition to this section of the Garn bill, we applaud the fact that Senators D'Amato and Mattingly also have introduced bills calling for some liberalization of geographic restrictions.

We believe it is essential that geographic restrictions be brought into conformity with the realities of the modern marketplace. This proposal, Title X of the bill, is an important first step toward this goal. It respects the rights of states and preserves the dual banking system. And it further encourages innovation and experimentation as a possible prelude to nationwide banking.

Today we see several examples of states or groups of states, which are taking the initiative on the issue of interstate banking, enacting in some cases, reciprocal banking agreements as between New York and Maine. These actions threaten to preempt discussion on the larger more important issue -- a national policy on interstate banking.

The Administration's preference would be to see enacted a nationwide policy for interstate banking activities. However, in lieu of a national approach, we would support state initiatives in this area.

Interest on Reserves

Title IV of this bill would permit depository institutions to earn interest on their required reserves held against money market deposit accounts (MMDAs) and Super-NOW accounts. This proposal, which is designed to make MMDAs and Super-NOW accounts more competitive with money market funds, would help depository institutions achieve greater competitive equity and enable depositors to obtain a market rate of interest.

The Federal Reserve has estimated that the initial annual revenue reduction would be $125 million and that this figure would rise over time as deregulation proceeds and these types of deposits become more important. For this reason, the Administration would only be able to support an approach which does not increase a deficit which is already much too large.

CONCLUSION

In conclusion, Mr. Chairman, I want to again emphasize the need for legislation on holding company deregulation, as well as our conceptual support for your proposal. We need action. And we need it this year. We in the Federal Government are way behind the private sector in this area. We have a problem crying out for a solution. Senator Garn's bill, which we have been discussing today, is certain to set the framework for answering many questions and solving many of the problems raised.

Let me leave you with this final thought. As Winston Churchill once said: "Some see private enterprise as a predatory target, others as a cow to be milked, but few are those who see it as a sturdy horse pulling a wagon." Mr. Chairman, I think we are in agreement that private enterprise is indeed a sturdy horse, pulling this country toward greater prosperity.

We stand ready to work with you, your Committee and the Congress in any way we can, to further deregulate the financial industry -- for the good of the country and its citizens.

* * * *

Mr. Chairman, that concludes my testimony. I will be pleased to answer any questions the Committee may have.

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Testimony

of the

Honorable Donald T. Regan

Secretary of the Treasury

before the

Senate Committee on Banking, Housing and Urban Affairs

Mr. Chairman and members of this distinguished Committee:

It is a pleasure to have an opportunity once again to present the Administration's views on the financial reform proposals now pending before Congress.

More than anyone else, Mr. Chairman, you are to be commended for your timely response to the legitimate demands for restructuring the Nation's financial marketplace. In 1982 you, in cooperation with Congressman St Germain, were responsible for the achievement of landmark financial reform legislation -- the "Garn-St Germain Depository Institutions Act of 1982". Your current omnibus legislation -- the "Financial Services Competitive Equity Act" (FSCEA, S. 2181) -- represents another comprehensive and ambitious proposal, the enactment of which would benefit significantly the consumers, as well as the providers, of financial services. You and your Committee are to be congratulated for your efforts.

PREFACE

I would like to limit my remarks today to an overview of the issues we believe are most significant and the principal differences between pending proposals and the Administration's Financial Institutions Deregulation Act (FIDA, S. 1609). At a later date I understand we will be given an opportunity to present our views in greater detail.

However, I do want to make a number of points clear at the outset, so that they won't be lost sight of in our subsequent discussion. First, I want to emphasize that there should be no doubt whatsoever that the Administration supports the overall thrust of the "Financial Services Competitive Equity Act" as a substitute for FIDA. Even since I last spoke to this Committee on July 18, 1983, market pressures have continued to exert themselves, making it all the more important that we arrive at an equitable resolution of the issues of financial deregulation. S. 2181, like FIDA, would accomplish that deregulation through the expansion of the product powers of depository institution holding companies, which remains the preferred approach of the Administration.

Secondly, the Administration is prepared to support the provision in FSCEA for a "qualified thrift lender" which would be exempt from the restrictions of the bill even though this represents a departure from FIDA. As I discuss in more detail later in my statement, we are concerned only that this exception be kept sufficiently narrow to accomplish its purpose and to avoid abuse.

Finally, we note that S. 2181 includes stronger anti-tying provisions than those contained in FIDA. The problem of potential tie-in arrangements was addressed in the Administration's bill, but many affected parties have since argued that some strengthening of our original provisions is necessary. It seems to us that FSCEA responds appropriately to those concerns.

FINANCIAL RESTRUCTURING ISSUES

The issues that need to be addressed to promote competitive equity in the financial services industry are complex and in many cases controversial, giving rise to a number of fundamental questions. For example:

-- What are the essential purposes of the Bank Holding Company Act (BHCA), the Savings and Loan Holding Company Act and the Glass-Steagall Act?

-- How can these laws be modified to give providers and consumers of financial services the benefits of increased competition and less onerous regulation without diminishing the essential objectives of regulation?

-- If there is reason to draw a line between "banking" and "commerce", where should this line be drawn?

These are difficult questions that Congress must answer if it is to keep pace with a dynamic financial services environment and set the stage for equitable competition in the future. In this respect, I would like to commend Chairman Garn and Senator Proxmire on their respective bills, S. 2181 and S. 2134, to deregulate depository institution holding companies. Their proposals make significant progress in focusing the debate on these issues. Hopefully they may provide a basis for achieving consensus on legislation.

While the Administration does not agree in all respects with the solutions proposed by S. 2181 and S. 2134, we clearly see the prospect for workable legislation in the underlying approaches taken in these bills. FIDA initiated the discussion and now it will continue in the context of the Garn omnibus bill. I am confident that Corgress, recognizing the urgent need for financial services reform, will be able to work constructively with us and all interested parties to arrive at acceptable compromises that serve the best interests of the public.

Also, I want to emphasize that we believe that product deregulation, i.e., the service powers of financial institutions and their holding companies, should receive priority consideration by Congress. Once this issue has been satisfactorily addressed, then the questions of regulatory structure and regulatory responsibility -- currently under study by a Task Group chaired by Vice President Bush -- should become the subject of serious Congressional attention.

THE NEED FOR NEW FINANCIAL DEREGULATION LEGISLATION

The need for the type of legislation we are considering today is evident in the financial markets all around us. For one thing, our traditional depository institutions are being faced with a less-regulated market for deposit funds. At the same time, many non-banking firms are entering the traditional markets of depositories, soliciting as best they can the more attractive and profitable business for themselves. The combination of these two factors -- increasing costs and decreasing revenues -- is placing pressure on net interest margins and calling into question the viability of commonplace depository institution distribution systems and restricted product lines. As a consequence these institutions are seeking out substitutes for their old and costly brick-and-mortar branches, and they are attempting to broaden their product lines (especially into securities and insurance activities) in order to remain competitive in the future.

Recent years also have witnessed certain developments that are progressively minimizing the traditional distinctions between banking and nonbanking services. Diversified nonbanking firms such as Sears-Roebuck, Merrill Lynch, Shearson/American Express, and Prudential-Bache are rapidly approaching the point where they can offer one-stop financial shopping. Of critical importance to the diversification plans of many of the non-regulated financial institutions has been the acquisition of a depository institution. The emphasis in this respect has been on the so-called nonbank bank -- a source of insured deposit funds with direct access to the payments mechanism.

Finally, a progressively more sophisticated consumer is demanding, and expects to receive, major benefits from a more innovative and responsive financial services marketplace. Only as more firms are able to offer consumers a wide variety of financial products at competitively lower prices and greater convenience will the new needs of consumers be satisfied.

All of these institutional and consumer "initiatives" have tended to destabilize somewhat our financial marketplace, and in some cases have stimulated state legislatures and Federal regulators to take their own, often uncoordinated, measures to deregulate the financial services industry. Without action by Congress this type of chaos will become commonplace and, ultimately, interests will be put in place that will make comprehensive and balanced reform next to impossible.

IMPORTANCE OF THE HOLDING COMPANY REQUIREMENT

I am particularly pleased that both S. 2181 and S. 2134 would adopt the holding company approach the Administration has been advocating for several years and has embodied in its current FIDA proposal. All three of these bills would require nonbank or non-thrift activities to be performed through a holding company or its nondepository affiliates and not in the depository institution itself. There are several reasons why the Administration believes strongly that the holding company structure is the only acceptable means of expanding nonbanking activities.

Banks and thrifts are unique financial intermediaries affected with a public interest. As such, they are Federally-supervised, have access to a Federal lender of last resort, and have some portion of their deposits Federally insured. The Administration does not believe that these institutions should directly engage in new and risky activities that cannot be regulated effectively by a single bank regulatory agency. This would place an inappropriate supervisory and insurance burden on the Federal Government. Moreover, the unique status of depository institutions enables them to raise money in the private financial markets at a lower cost than most other borrowers by allowing the payment of lower explicit returns and/or by enabling them to overcome more easily the caution of potential investors in placing their funds with the institutions. These institutions should not be able to use the lower cost funds to engage directly in activities with non-depository institution competitors or to capitalize direct subsidiaries at advantageous transfer costs.

The Administration, in addition, does not believe that non-depository institution activities should be conducted through a subsidiary or service corporation in which a bank or thrift has a direct equity investment. Again, the investment would be at risk if the subsidiary's activities were to falter, and the funds for the investment would be raised with Federal assistance not available to non-depository institution competitors and at a cost advantage to the bank or thrift. In addition to permitting equivalent regulation of functionally equivalent activities, the adoption of the holding company approach as the underlying principle of depository institution deregulation would remove many of the inconsistencies and anomalies that currently confuse the issue of bank deregulation.

DIFFERENCES BETWEEN THE "FINANCIAL SERVICES COMPETITIVE EQUITY ACT" AND FIDA

Title I of S. 2181 is based on the Administration's FIDA proposal. Its major provisions would substantially deregulate the range of financial services that can be offered by depository institution holding companies largely along the lines of FIDA. We fully support the expansion of holding company activities provided in this bill.

Even though Title I is based on the Administration's holding company model, there are a number of important differences. The more significant of these differences involve (1) an exception from bank holding company regulation for a "consumer bank", (2) an exemption from activities restrictions for a unitary savings and loan holding company the subsidiary of which is a "qualified thrift lender", (3) a limitation on the size of combinations of holding companies and other financial intermediaries, (4) a limitation on branching and interstate acquisitions, and (5) more stringent anti-tying provisions.

Consumer Banks. FIDA defines "bank" for purposes of the BHCA to include (1) any FDIC-insured bank, (2) any institution eligible for FDIC insurance, and (3) any institution that both accepts demand deposits that the depositor may withdraw by check or similar instrument for payment to third parties and engages in the business of making commercial loans. This would have closed the nonbank loophole by subjecting any company that owns a Federally-insured bank to the BHCA.

S. 2181 uses essentially the same definition of bank for purposes of the BHCA but specifically excludes from this definition any "consumer bank". The bill defines a consumer bank in general to mean a bank that does not engage in the business of making commercial loans. Because the bill excepts consumer banks from the definition of bank, companies that use only these institutions would not be subject to the BHCA, and consequently would be free to engage in any nonbanking activity, including securities activities. However, the Glass-Steagall Act would continue to prohibit affiliates of Federal Reserve member banks, even if they are consumer banks, from engaging in certain securities activities, including corporate underwriting, if that was their principal activity. Thus, while FIDA would have closed the nonbank bank loophole completely, S. 2181 explicitly authorizes this type of nonbank bank. This could create some competitive inequity, since firms with only consumer bank subsidiaries could offer Federally-insured deposits through their consumer bank subsidiaries, together with any other product or service, while traditional bank holding companies whose banks are not consumer banks could offer only limited services.

There can be no doubt that Federal deposit insurance will provide consumer banks with a competitive advantage. This is so because their cost of funds will be relatively lower than that of non-insured competitors and, unlike most of their insured competitors, they will be exempted from the restrictions of this legislation. One of those restrictions, of course, involves the more stringent anti-tying provisions deemed necessary for other Federally-insured depositories affiliating with non-regulated entitites. On balance, the consumer bank device will enable many diversified firms to get into the banking business, and the consumer bank itself will be able to utilize Federal deposit insurance to its competitive advantage, without much of the Federal regulatory burden imposed through holding company regulation.

The Administration has not yet taken a final position on the consumer bank issue. There is some real appeal to the concept of eliminating completely the regulation of holding companies for depository institutions, which is the effect of authorizing a consumer bank, and we are interested in hearing additional discussion of the advantages of the consumer bank as well as further specification of its operational scope and restrictions. Nevertheless, the Administration remains concerned about the problem areas discussed above.

Qualified Thrift Lenders. FIDA subjects both unitary and multiple savings and loan holding companies to the restrictions on nonbanking activities of the Savings and Loan Holding Company Act, which would be changed so that they are the same as those under the BHCA. S. 2181, however, provides an exemption from the activities restrictions for any unitary savings and loan holding company the sole thrift subsidiary of which is a "qualified thrift lender". A qualified thrift lender under S. 2181 is defined to mean a thrift (1) with no more than 25 percent of its assets invested in commercial loans, nonresidential real estate loans, property for commercial leasing purposes, and floor planning or inventory loans, or (2) with not less than 60 percent of its assets invested in domestic residential mortgage lending, including mortgage-backed securities, loans, and property used by a thrift in its business. Because a thrift may qualify under either test, a company owning a thrift that makes no housing loans may engage in any activities it chooses.

In effect, this proposal is a consumer bank exemption for unitary savings and loan holding companies. It does not require any residential real estate lending as long as commercial loans do not exceed 25 percent of the institution's portfolio (and would permit up to 40 percent commercial loans if real estate lending amounts to 60 percent of the portfolio). Because a qualified thrift lender has five times the commercial lending authority of the consumer bank and there is no requirement that it make any residential mortgage loans, it is likely to be a preferable way for a diversified financial services firm to get into the banking business. Indeed, many one-bank holding companies may be tempted to turn their banks into qualified thrift lenders in order to avoid holding company regulation.

The Administration is not opposed to providing for a "qualified thrift lender" exemption but believes that, in the interest of competitive equity, the exemption should be kept as narrow as possible and essentially be tied quite tightly to residential real estate lending. In this respect, we would recommend that thrifts be considered qualified thrift lenders only on the basis that they be allowed to have only a small portion of their assets invested in loans other than residential real estate, and that this be the only exemption for a qualified thrift lender.

In addition, we recognize that savings banks are sufficiently unique to justify a different "test", such as, for example, combining a requirement that a specified portion of their loans be in residential real estate along with a generous time period for phasing-in to the qualified thrift lender test suggested above.

With regard to service corporation activities, FIDA generally restricts the service corporation activities of all Federally-chartered banks and stock thrifts to those of a clerical nature or those related to the financial institution's internal operations.

Recognizing that thrifts in mutual form are unable to expand their nondepository activities through a holding company, FIDA permits them to continue to invest in service corporations that engage in any thrift service corporation activities authorized on July 1, 1983. These activities include clerical activities as well as various other activities such as acquiring, developing, and managing real estate, engaging in interest-rate futures transactions, and selling insurance.

S. 2181 provides the same service corporation authority as FIDA, but also permits qualified thrift lenders to invest up to three percent of their assets in a service corporation without any statutory limitations on the service corporation's activities. This special authority provided only to qualified thrift lenders is the same liberal authority provided under current law to all Federal thrifts, whereby the Federal Home Loan Bank Board determines the extent of permissible activities. Thus, under S. 2181, qualified thrift lenders would be authorized to engage, through their service corporations, in more activities than banks and stock-thrifts, which are generally limited to clerical and internal operations activities, and even in more activities than mutual thrift service corporations (that are not also qualified thrift lenders), which are limited to such activities permissible on July 1, 1983.

We have serious reservations about this broad service corporation exemption because it permits some financial service firms to diversify within the depository institution rather than through the holding company and thereby creates competitive inequities with firms subject to holding company regulation. We believe that the limitations on service corporation activities of qualified thrift lenders should embody the same principles as FIDA, with appropriate differences being made for stock thrifts and mutual thrifts.

Size Limitations. FIDA authorizes bank holding companies to acquire, without size limitations, any company engaged in insurance, securities, real estate (except for a five percent of capital limitation), or other permissible nonbank activities, and permits companies of any size engaged in these activities to acquire banks. S. 2181 likewise authorizes holding companies to engage in these activities but prohibits combinations between depository institutions with three-tenths of one percent of U.S. domestic deposits and a company or companies engaged in these activities if the resulting holding company has an investment in any one such activity that exceeds 25 percent of the company's consolidated capital. We understand that this would cover approximately the 25 largest bank holding companies.

These restrictions have been proposed in response to public policy concerns over the potential for what has been called "undue concentration of resources". Many believe that the current anti-trust laws are inadequate to prevent such concentrations.

However, the Administration is not convinced that size is inherently bad or that current anti-trust laws are inadequate and, accordingly, we do not believe that any restriction on institutions' size other than those under existing anti-trust provisions is necessary.

Geographic Limitations. FIDA authorizes bank holding companies to acquire thrift institutions without placing an interstate limitation on such acquisitions. Current law, which would not be changed by FIDA, would prohibit the acquisition of thrifts in more than one state. Thus, the effect of FIDA would be to allow a bank holding company to acquire a thrift or thrifts located in one state outside of the state where its bank operations are located.

S. 2181 would close this means of interstate expansion by making the acquisition of a thrift by a bank holding company subject to the Douglas Amendment prohibition on interstate banking as if the thrift were a bank. Accordingly, a bank holding company could acquire a thrift only in its home state or in a state that specifically authorizes such an acquisition by statute. The bill also subjects prospectively thrift subsidiaries of bank holding companies to McFadden branching restrictions. Thus, a thrift subsidiary of a bank holding company could only establish additional branches at locations where a national bank would be authorized to establish branches. FIDA contains a similar authorization for savings and loan holding companies to acquire banks without an interstate limitation. Again, S. 2181 would subject these acquisitions to the Douglas Amendment so as to prevent the expansion of a savings and loan holding company into an additional state through a bank acquisition. Supervised acquisitions made in financial emergencies would not be subject to these restrictions.

The question of geographic restrictions is important and controversial. We believe that geographic restrictions ought to be brought into conformity with the realities of the modern marketplace as soon as possible and we are ready to work with the Congress to reach a national solution to this issue. In the interim, we are not inclined to object to these provisions of S. 2181 and we support the regional experimentation provided under Title X.

Anti-tying Provisions. While the BHCA and the Home Owners' Loan Act contain general prohibitions against a bank or thrift tying its services to other services offered by the depository or its holding company affiliates, the insurance industry and others have expressed concerns that current law does not provide standards sufficiently specific to ensure against increased potential abuses, particularly in connection with the offering of both traditional banking services and insurance underwriting or brokerage services.

While FIDA contains a provision permitting trade associations to bring actions for injunctive relief under the anti-tying provisions on behalf of any of their members, it does not add specific restrictions on how insurance may be sold. Senator Garn's bill includes FIDA's amendment but also adds several new provisions intended to protect against the tying of services by holding companies. These provisions would require a bank (1) to explain in writing to a credit customer that credit insurance may be purchased from an independent insurer, (2) to give a written commitment that credit will be extended before soliciting insurance to provide a borrower with a written statement stating reasons for a rejection, (3) not to reject unreasonably a contract for insurance and to provide a borrower with a written statement stating reasons for a rejection, (4) not to require payment of a separate charge by a borrower, mortgagor, purchaser, insurer, broker or agent for handling an insurance contract required as security, or for substituting the insurance policy of one insurer for another, (5) not to require any procedures or conditions of duly licensed agents, brokers, or insurers not customarily required of agents, brokers or insurers connected with the bank, (6) not to disclose, without prior written consent, information on credit insurance, and (7) to accept cancellation of a credit insurance contract if notified by the borrower within 30 days and refund the unearned portion of the premium.

Under current law thrift institutions are subject to essentially the same restrictions on tying services as are banks. Both FIDA and S. 2181 contain a provision parallel to that provided with respect to banks, authorizing trade associations to bring actions for injunctive relief under the anti-tying provisions on behalf of any of their members. The additional Garn bill restrictions, however, are not made applicable to thrifts.

It should be noted that under FSCEA consumer banks, because they are excluded from the definition of bank, would not be subject to any of the anti-tying provisions of the BHCA.

Recognizing the concerns of the insurance and other industries about tying, the Administration would not oppose FSCEA's stronger anti-tying provisions for all depository institutions, including thrifts and consumer banks, provided that these provisions did not amount to unnecessary re-regulation.

DIFFERENCES BETWEEN THE "DEPOSITORY INSTITUTIONS HOLDING COMPANY ACT AMENDMENTS OF 1983" AND FIDA

S. 2134, introduced by Senator Proxmire, is similar to FIDA in that it adopts FIDA's definition of "bank" for purposes of the BHCA, authorizes bank holding companies to engage through nonbanking affiliates in most securities activities other than corporate underwriting, and streamlines regulatory review procedures. It differs from FIDA with respect to (1) the extent of permissible activities, and (2) the applicability to savings and loan holding companies and bank and savings and loan service corporations.

Permissible Activities. The bill would not authorize bank holding companies to engage in new insurance or real estate activities or activities determined to be "of a financial nature". Although new securities activities are an important first step in creating competitive equity between banks and other financial service firms, we believe FIDA's new insurance and real estate powers are a logical extension of current authority that would provide consumers with the benefits of increased competition and diversification. Moreover, by omitting "financial nature" activities, S. 2134 fails to provide a regulatory framework by which banks could keep pace with future developments in the financial services industry.

Powers of Savings and Loan Holding Companies and Bank and Savings and Loan Service Corporations. S. 2134 does not provide parallel treatment of bank and thrift holding companies. Thus, in our view it disregards the fundamental similarity of banks and thrifts under recent legislation and, as a result, perpetuates a regulatory imbalance based on industry classification.

The bill eliminates the unitary thrift holding company exemption where the subsidiary thrift is not fully committed to the provision of credit for the purchase of residential housing or where a parent holding company seeks to integrate the thrift's operations with those of the parent. This provision has the beneficial effect of further restricting the use which may be made of the qualified thrift lender or the unitary S&L holding company exemption by diversified financial services firms, and thus prevents these institutions from offering bank-like services when bank holding companies are limited in the nonbanking services they can offer. As I have indicated above, we are prepared to accept some form of exemption for unitary thrift holding companies but believe the exemption should be narrowly drawn and perhaps include a separate test for savings banks, at least for some appropriate phase-in period.

S. 2134 continues to permit broader thrift service corporation powers, thereby endorsing a competitive disparity between banks and thrifts and creating artificial pressures for charter conversion. We have strong reservations about continuing this broad service corporation authority under current law.

OTHER TITLES OF S. 2181

Senator Garn's bill contains additional titles that address, among other issues, (1) interest on demand deposits, (2) interest on reserves, (3) preemption of state usury ceilings, (4) interstate banking, (5) credit/debit card fraud, (6) consumer lease/rental-purchase agreements, and (7) check holding practices.

Interest on Demand Deposits. The "Demand Deposit Deregulation Act" (S. 1875), which was submitted to Congress by the Depository Institutions Deregulation Committee (DIDC), is incorporated in S. 2181 as Title VIII. This Act would repeal the prohibition against payment of interest on demand deposits and would authorize the DIDC to establish rate limitations for interest on demand deposits that would be tied to NOW account rates (in order to moderate the initial cost impact on depository institutions).

While the Administration supports the payment of interest on demand deposits as a matter of principle, we believe that demand deposit deregulation should be viewed within the context of a commitment to more comprehensive product deregulation. As I discussed earlier in my statement, the deregulation of deposit liabilities puts increasing pressure on net interest margin, and product expansion will become progressively more important to the economic well-being of bank and thrift organizations.

Interest on Reserves. The "Competitive Savings Incentive Act of 1983" (S. 1750), which has been incorporated as Title IV of the bill, would permit depository institutions to earn interest on their required reserves held against money market deposit accounts (MMDAs) and Super-NOW accounts.

This proposal is designed to make MMDAs and Super-NOW accounts more competitive with money market funds. It therefore would help depository institutions to achieve greater competitive equity and enable depositors to obtain a market rate of interest. We are in sympathy with the desirability for equity in this case. However, the proposal also would entail a reduction in the Federal Reserve's payment to the Federal Treasury. The Federal Reserve has estimated that the initial annual revenue reduction would be $125 million and that this figure would rise over time as deregulation proceeds and these types of deposits become more important. For this reason, the Administration would only be able to support an approach which does not increase a deficit which is already too large.

Preemption of State Usury Ceilings. The "Credit Deregulation and Availability Act of 1983" (S. 730), which has been included as Title VII of the bill, preempts all remaining state usury ceilings on business, agricultural, and consumer loans. However, it gives states the right to reimpose interest rate restrictions at any time within three years of the date of enactment, and it leaves intact all state consumer protection laws. The bill also eliminates usury ceilings applicable to Federally-chartered credit unions.

The Administration testified in favor of this bill early last year and continues to support this element of the omnibus package.

Interstate Banking. The question of interstate banking has been a major one facing policymakers for many years. We are especially pleased to see that a number of concrete proposals have been introduced to address this question. In addition to Title X of S. 2181, we applaud the fact that Senators D'Amato and Mattingly also have introduced bills calling for some liberalization of geographic restrictions (S. 2107 and S. 2113, respectively).

The "Interstate Banking Act of 1983" -- Title X of the bill -- essentially provides the Federal Government's affirmation, for a five year period, of regional interstate banking arrangements as well as other state initiatives on the interstate banking issue.

This proposal helps to bring geographic restrictions on banking more in line with current marketplace realities. It respects the rights of states and preserves the dual banking system. It further encourages innovation and experimentation as a possible prelude to nationwide banking.

The formation of regional compacts does, however, discriminate against institutions precluded from participation. It also raises the possibility that regionally dominant institutions might be protected from outside competition. Action by individual states or groups of states also postpones the resolution of a national policy on interstate banking. The Administration's preference would be to resolve a nationwide policy for interstate banking activities, but we believe that a full resolution of this difficult question should not be allowed to impede the product deregulation initiative contained in Title I of the bill. In the absence of a national approach, however, we are inclined to support state initiatives in this area.

Credit/Debit Card Fraud. The "Credit and Debit Card Fraud Act" (S. 1555), Title IX in the bill, is designed to expand and strengthen credit card fraud statutes. Although current law treats some fraud involving stolen cards, it does not cover other areas of abuse. In addition, there is a conflict in the courts concerning whether misuse of account numbers technically constitutes fraudulent use of a credit card and is therefore prohibited by the existing criminal provisions of the Truth-in-Lending Act. Title IX would close this loophole by defining "credit card fraud" to include misuse of an actual or fictitious account number.

The Justice Department recently testified before the Senate Judiciary Committee in favor of a related bill, S. 1870, that provides penalties for credit and debit card counterfeiting and related fraud. The Administration continues to support these provisions.

Consumer Lease/Rental-Purchase Agreements. The "Consumer Lease and Rental Purchase Agreement Act" (S. 1152), Title V in the bill, amends provisions in the Consumer Credit Protection Act so that consumers will have easy access to all essential data concerning their costs and responsibilities regarding consumer leases. This legislation also would extend similar disclosure requirements for the first time to rental purchase agreements.

For the moment, at least, we are inclined to allow the Federal regulatory agencies to take the lead with respect to the policy aspects of Title V. However, we clearly will be interested in making technical comments on this proposal as it moves towards final enactment.

Check Holding Practices. The "Fair Deposit Availability Act of 1983" (S. 573), Title VI, was drafted in response to consumer concerns over relatively lengthy holds placed on checks by numerous depository institutions before making the funds available to depositors. The Act would require depository institutions to inform customers of their hold policies both at the time a person opens a new account and at the time a person deposits a check if the funds will not be available immediately. It also would require a depository institution refusing to honor a check of $250 or more to notify the depository institution at which the check was originally deposited within 24 hours. Depository institutions would be required to begin computing interest on deposits to interest-bearing accounts no later than the date on which the institution receives provisional credit for the deposit.

While we recognize that many consumers are concerned about the check holding practices of depository institutions, we do have some reservations about the policy implications and technical provisions of this particular proposal. In this respect, we intend to forward more detailed comments to the Committee in the near future.

CONCLUSION

In conclusion, Mr. Chairman, I want to emphasize once again the need for action on holding company deregulation. We in the Administration want to thank you and your Committee for moving forward so determinedly at this time. The omnibus legislation we have been discussing today is certain to set the framework for financial deregulation in the 1980s.

Commercial banks and other financial service firms are clamoring for resolution of the competitive inequities that arise under laws no longer in touch with marketplace realities. Consumers, although less vocal on these complex issues, nevertheless stand to benefit substantially from the convenience, product proliferation, and economies we believe will inevitably result from deregulation. Federal regulators, in deference to Congressional prerogative, for the moment have postponed action on those applications that would significantly restructure the industry. Congress will serve the country well if it can use this window of opportunity to take the lead on holding company deregulation.

We in the Administration stand ready to work with the Congress in any way we can to secure rapid passage of this much needed legislation.

* * * *

Mr. Chairman, that concludes my testimony. I will be pleased to answer any questions the Committee may have.

The CHAIRMAN. Thank you very much, Mr. Secretary. May I first thank you for your efforts in placing the Financial Institution Deregulations Act, S. 1609, before this committee, as well as for your assistance and help, and your comments in putting together my proposal for these hearings. It's been very, very helpful and your staff has been very helpful.

As you are well aware, neither you nor the Chairman of the Fed can ever go to a hearing—regardless of what the subject of the hearing is supposed to be—without being asked about the economy. Therefore, we thought we might as well get that out of the way with both of you at the outset, rather than waiting until later.

We had a good discussion with the Chairman of the Fed and he is very optimistic. The economy has improved much more rapidly than any of us thought. I think all three of us here and the Chairman are very concerned about what has been called by him a ticking time bomb, the deficits, in choking off what is a very, very strong recovery and expansion of the economy.

So we have decided that you should have equal time to discuss the nature of the deficits and your own forecasts for the recovery and expansion and the possibility of the deficit's impact on the expansion.

Mr. REGAN. Thank you for that privilege, Mr. Chairman. I had a mental battle as to how soon that question would come up. I think I win.

POSSIBILITY OF DEFICIT'S IMPACT ON THE RECOVERY AND EXPANSION

Seriously, we are concerned about deficits, as you are, and as the Chairman of the Federal Reserve is.

There is no doubt that large deficits year after year would be unsustainable for a complete economic expansion and a prolonged economic expansion. The question is, first of all, how to treat the deficits and then, second, when to treat them.

It has been my belief, as I said last year at this time, that we can handle the mammoth deficit in the Federal budget which occurred in fiscal 1983, and I think we can handle the one that is occurring in fiscal 1984.

Last year there were a lot of skeptics who said that the large Federal deficit would cause inflation and cause a very anemic and abnornal recovery. I believe those were the adjectives that were used. Well, those critics have been confounded by the strength of this recovery. I think all of us have been extremely pleased and surprised at the way unemployment has come down.

No one, I don't think, would have believed in December 1982 that unemployment would be at 8.1 percent at the end of 1983. Certainly it was not in our forecast nor in any other economist's that I know of. This is very welcome news and the idea is not just to have a recovery that continues for another 12 months, although I understand that that would be politically popular. I am not the politician in the Cabinet, as you know.

But all kidding aside, that's not what we want in this country. We should have prolonged recoveries and eliminate as much as we can of the business cycle, although I don't think we will ever completely eliminate it.

So we do have to treat those deficits because it's the way they are handled that impacts on the economy. If nothing were done to reduce those deficits and they came out at just under $200 billion and slowly drifted down to $150 billion over a period of years, then I think that while there could be a sustained recovery it would be an anemic one. The temptation would be there for inflation to come back, and by inflation I am talking about something well over 6 percent. That we don't want. Not in 1984, nor 1985, 1986, or in any other year. So, how to handle this problem?

Mr. Chairman, again I recognize that Senator Gorton is a member of the Budget Committee. And nothing I say here implies any denigration of the Congress. But I do want to say that we have a situation where the Federal budget has been growing at a rapid rate over the past decade, as a matter of fact two decades, to where at this particular moment, due to a recession more than anything else, we are spending at the Federal level about 24½ percent of our gross national product. This is much higher than it has been. When you consider that, you say, "Well, why all the spending?"

Everyone has good programs that he or she thinks should be adopted. These programs get started and they are never stopped and they continue to increase year after year. The result of all of this is that revenues simply don't keep up with increasing expenses.

Now, as a businessman, I am astounded at the way the Federal Government goes about setting its budget. It used to be, when I was a CEO and people were handing me budget books about the size of that one, we would start out by saying, "What's our forecast of revenues? What's the sales forecast? What's going to be our growth?" From there you figure out a reasonable margin of profit and get a good idea of what you could spend; and from there the chief financial officer took it to the departments that came back with budgets that added up to that amount. If they didn't, they were handed back the budget until they could conform.

No board of directors would accept from a CEO a budget with huge deficits in it unless they were planning somehow or other to put the corporation into chapter XI or XII—whatever.

In the Federal Government we don't do it that way. We start out with a wish list, if you like, of agencies and departments piling one on the other of what they want in spending. Many try to be prudent but almost everybody puts in a little extra so it can be struck down perhaps during the budget process. As a result, we come up with some horrendous figures that are nothing like our revenues.

But revenues continue to grow, Mr. Chairman. Our revenues in 1984 will be larger than they were last year, and 1985 will be larger than this year, and fiscal year 1986 revenues will be more than in 1985 and so on. And so, going along the path that we have assumed in our economic forecast, by 1988 we will have just under $1 trillion of revenue coming into the Federal Government, $964 billion. In 1989 we go over the $1 trillion mark as far as revenue is concerned. No new taxes, just on the path we are on. Growth at about 4 percent and inflation at about 5 percent.

SPENDING EXCEEDS REVENUES

With that normal 9 percent compounded year after year, you would think that $1 trillion would be enough for us to spend, but, indeed, we can't show that. We show us spending more than $1 trillion in the year we get the $1 trillion.

Now, what I have suggested to our administration is that we start to hold the line here and start cutting back before we think in terms of raising taxes for the simple reason that if you are going to just raise revenue to meet increasing expenses, where do you stop? I would prefer to see us stop somewhere in the 20 to 21 percent of GNP range and bring spending down and let revenues drift up as they will if they are allowed to. That certainly is the way to go about moving a budget toward balance.

At this point I am sticking on that, that is, I think the first thing to do is try to cut expenses, not raise revenue.

The CHAIRMAN. Mr. Secretary, I certainly agree with you. In the 9 years that I have served in the U.S. Senate there have been continual tax increases, not only revenue increases, due to growth in the economy which has upped the amount of revenue, but actual taxes increase also.

So we find ourselves, in Congress, with a debate between two extremes; those that wish to do it totally with tax increases and say that is the way to solve the problem, and those who prefer to do it all with expenditure reductions. I happen to be one of those.

But, recognizing that neither side of that question is possible, we start talking about combinations of tax increases and expenditure reductions to reduce the deficit. The problem with that is that every time we have had a tax increase in my 9 years, we got just what you are saying. We have spent more than the tax increase so there was no deficit reduction and that is my major objection in voting for a tax increase. Each and every time it has taken place—I sat on the floor of the Senate in 1977 when we talked about the revenue and the large tax increases to solve the problem of social security; and that if we would vote for that, it would fix the social security system for 75 years.

Now, even by congressional standards, to miss our 75-year projection by 70 years is gross.

But there was no restraint on spending in our tax reform. The last was in 1982 which was the only one I voted for, and I did so at the request of the President and others. That was the billion dollar tax to reduce the deficit. I was voting for that and justified it at home on two bases; that first of all I didn't want a tax increase of any kind, but that was $98 billion that we would have to borrow if we didn't have it. And second, that we were promised expenditure reductions of at least $1 for every $1 of revenue, giving you two for one.

You are talking about $200 billion net effect of a tax increase. Even then, I grudgingly voted for it.

Depending on whose estimate was used, the problem was there were expenditure increases of $1.04 for each $1 of tax increase. So I can't emphasize enough that we must have some reductions in expenditures or you can't tax this country enough to ever catch up. I won't go beyond that.

I could use other examples but I use my personal experience for 9 years that the deficits have grown. I sat on the floor of the Senate in 1975 when Gerald Ford presented his budget. It was $295 billion and we passed $318 billion. John Kennedy ran the entire country 21 years ago for $106 billion. That was total, and 48 percent of that budget was for the military. That was just 21 years ago.

Today, or just in my 9 years, I have seen $300, $400, $500, $600, $700, $800, and almost $900 billion, and $130 billion of interest, give or take a few billion dollars of interest, which is more than Kennedy ran the entire country for. So I can't subscribe to the fact that the only way to solve the problem is tax increases, because it requires a total change of what we have been doing. It hasn't happened in the last 9 years. The revenue increases have been substantial during that period of time. It's like the fellow getting the raise. He always spends more than his raise, and that's what Congress has done.

I think the only way we are going to get to a solution of that problem is both sides have to give. There is going to be a compromise that is going to be tied up in a proposal that ties both of them together. That's the reconciliation process, and I'm getting out of my committee jurisdiction, but I won't personally vote for a tax increase again of any kind unless that vote also carries with it expenditure reductions so we don't get lied to again as we have over and over again.

How we achieve that legislatively, I don't know. But I don't see any way out of those budget deficits until we get that kind of consensus or compromise tied up in one package or we'll get revenue increases and expenditure increases to go with it or the deficit will increase and we'll talk about a $1½ trillion budget in another 9 years. Maybe even sooner. My time is up.

Let's now turn to the Budget Committee. Senator Gorton.

Senator GORTON. Thank you, Senator. I hope I have time to ask the Secretary about your bill.

The CHAIRMAN. So do I.

Senator GORTON. If I may, I would like to ask one or two questions about the subject on which we are speaking here.

Mr. Secretary, you pointed out, I think quite accurately, that without any change in our tax laws that revenues will increase at approximately 4 percent a year plus what we hope will be a very modest amount of inflation from now to 1989. In that period of time against that set of circumstances, will the percent of the gross national product which is represented by taxes or other revenues to the Federal Government increase substantially or at all?

Mr. REGAN. Not nescessarily, Senator, because the GNP will be growing about in line with taxes if we do nothing. Particularly when we start indexing personal taxes.

Senator GORTON. So the growth of the economy goes up with tax revenue.

Mr. REGAN. More or less. And it will stay between 19 and 20 percent of GNP.

Senator GORTON. And you also say it is your view that the Nation will be far better off if we reduce spending as a percentage of gross national product from the 24 or 25 percent range in which it falls in the present time to a 20 to 21 percent range.

Mr. **Regan**. That is correct.

Senator **Gorton**. And during the 1970's that was pretty close to the percentage of the gross national product which you were talking about?

Mr. **Regan**. That is right.

DEALING WITH ENTITLEMENT PROGRAMS

Senator **Gorton**. Mr. Secretary, having set out those two goals, do you believe it possible to reduce spending as a percentage of the gross national product to that 20 or 21 percent range without substantial reforms in entitlement programs which now represent close to half of our spending either as to their eligibility or at the very minimum to the cost of living adjustments which accompany most of them or the national budget? Is it possible to get to the 20 or 21 percent without dealing with those two spending items?

Mr. **Regan**. In all honesty, probably not, Senator. I think something will have to be done in those areas. In the area of entitlements, for example, we know that at the current rate the medicare trust fund is being spent, the trust fund will be broke in about 1987 or 1988. So we have to come to grips with major changes in medicare as an example. Whether we cap it or change it somehow or make it more into a health insurance program, these are the things I think we should start to debate now rather than waiting until 1986 and 1987 and then having to do it hastily as we did with Social Security in 1983 with the so-called Greenspan Commission.

Senator **Gorton**. Obviously I fully agree with that comment, Mr. Secretary. In fact, is it not true that if we were to accept the President's proposal for national defense and at the same time were not to reform any of the entitlement programs, we could repeal every other spending program and we would not balance the 1989 budget; would we?

Mr. **Regan**. Yes; if we repealed everything and did away with the Federal Government. That might not be all bad. But I think we are spending about $250 to $300 billion in nondefense discretionary domestic programs in the current budget out of a total of $850 billion. I think defense is another $300 billion. Interest is $125 or $130 and the remainder is in the entitlement programs.

Senator **Gorton**. And I think those totals would come up with more than the actual budget, Mr. Secretary. I don't want to quarrel but I think as we look at 1989 literally if we repealed everything else we would not balance the budget under those circumstances.

What have you recommended to the administration or do you expect the administration to recommend to us in a week or so about controlling either the growth of the national defense budget or the entitlement programs?

Mr. **Regan**. Senator, I beg for a little mercy on this one since the President himself would like to disclose his own budget and would also like to describe what he is trying to do. I think I should leave it to him on January 25 with his state of the Union message to the assembled Congress.

Let me put it this way: I think you will see suggestions of cuts in spending and minor tax increases sort of as a down payment, if you will, on what the President will suggest he thinks we should be doing in 1984 in preparation to doing something more in 1985 when it seems a more feasible time to do it.

Senator GORTON. Thank you. I think your answer is not unexpected, Mr. Secretary. I simply would like to state that I will find encouraging any recommendations by the President or the administration to begin dealing with this problem now in the only field in which I think a solution can be reached, entitlements and the defense and revenues and the like.

I agree totally with my chairman, that the price for my support for any increase of tax action is going to be that we get a guaranteed cut in some of the spending programs. I would only urge that we try much more than the modest down payment in 1984 on that process. My own view is that even from a political standpoint dealing with these problems decisively at this point will pay real dividends rather than cause fear and rejection since those problems are so important to all of us.

Since I don't have my card——

Mr. REGAN. I might tell you that in the tax field what I am proposing is that we reintroduce measures that we tried to have enacted last year that passed the Senate Finance Committee but didn't go anywhere on the floor because the House got into quite a squabble between Rules and Ways and Means. As a result, no tax revision bill came up.

Some of these parts, I think, do need revising. I won't bore you with all the details, but it's no secret that I'm looking at tax shelters and industrial revenue bonds for some type of tax. I'm also looking at the insurance industry. Some type of tax should be put on it. Probably some type of health tax; that is, benefits being paid by an employer for an employee. If that package were enacted, it would glean over a 5-year period an additional $75 to $78 billion in revenues.

Senator GORTON. Thank you, Mr. Secretary. On the subject of the bill—and I notice that when you were reading your statement, mine may be set up a little differently than yours. But in the middle of page 4——

Mr. REGAN. I have a copy that is the same as yours.

SUPERMARKETS VERSUS THE CORNER GROCERY STORES

Senator GORTON. It's in the middle of page 4. "The question is the supermarket versus the corner grocery store. The answer is: Both can and will survive in a competitive, deregulated environment; in a free market both will find an appropriate niche."

I find that to be an interesting analogy, one which I suspect is cold comfort to many people and institutions in the financial situation at the present time who suspect they will end up being corner grocery stores pursuant to this philosophy; insurance brokers, a number of security brokers, perhaps realtors and the like.

Perhaps you would be willing to describe in more detail than you have done just here who would be the supermarkets and who would be the corner grocery stores. Are the supermarkets going to be the Sears and the Citibanks of this world and everyone else is going to be a corner grocery store?

Mr. REGAN. No. I doubt that. I was looking for an analogy, Senator, to try to describe more accurately what I see coming. This is happening in other industries besides the chainstore industry, the drug store industry for example. There are many examples of how this has happened.

What I am trying to say is that even though there would be national chains in the financial services industry competing with each other just as Safeway, A&P, Grand Union, and others compete nationally now, at the same time there would be large regional chains that would be competing. At the same time you would have a lot of independent stores, like the 7-Eleven's back East. I don't know what they are called here in Salt Lake City. Perhaps Senator Garn can tell us that. But they are convenience stores that stay open at odd hours and sell packages of different types of things and make it easier for the local consumer.

The small town banker will not disappear. The individual real estate agent will not disappear. He has his customer's interest at heart and knows his customer inside out. Many people prefer to deal with that type of entrepreneur. Others prefer the convenience of dealing with a nationwide chain, because of either price or perhaps ease of being able to do more than one thing in a particular institution and getting complete, will rounded service. So I think that what will happen will depend strictly on consumer choice.

What I am trying to forecast is based on my experience on Wall Street when we were told that breaking a commission rate structure, and I led that fight, would lead to the demise of Wall Street. Somehow or other that hasn't happened. There are more brokerage firms in existence today than there ever were. Those giant firms have stood alone or merged with larger firms. Nonetheless, the individual firm is still there 8 years later.

So I don't predict the end of the small town banker or the small bank, thrift or insurance company in the large or larger city.

Senator GORTON. Thank you, Mr. Chairman. My time is up.

The CHAIRMAN. Senator Lautenberg.

Senator LAUTENBERG. Mr. Secretary, you and I, I think, have set an example in our career changes that would serve as a barometer for what we ought to do in the Federal Government in terms of our salary changes when we took office.

I just want to say to my respective Chairman that in the 9 years he has been in office, Government spending went up to $900 billion. I've been in office 1 year and interest rates have gone down, unemployment has come down. Sorry Jake.

The CHAIRMAN. He knows I'll get even.

Senator LAUTENBERG. He'll get even madder.

Mr. Secretary, part of the debate that's gone on here today, and frankly my own concern, is what happens to the individual that Senator Gorton referred to as being serviced or his questions about the supermarket and corner store analogy? I wonder what we are trying to accomplish with this move toward deregulation in terms of the kind of result that we want to have.

Do we want to make sure that the banking institutions, the financial institutions, protect their profits by offering a larger variety of products or is that in competition in any way or opposition to the services of the local consumer? I feel it is.

I don't think deregulation of and by itself is necessarily a noble objective. I think one of the worst things that has happened in our society is the deregulation, if you will, of AT&T. Everybody knows it is going to cost us a lot of money in the short run and, I suspect, even more in the long run.

In terms of the airline business, it's been great for some local service and there's some clients that are disenfranchised for all intents and purposes. So deregulation does not necessarily benefit all the parties, and you very well know that.

It appears that the banking industry has not suffered by the condition that presently exists. You see here in the Federal Reserve bulletin, this is a report on the first half of 1983; and that interest margin for all insured banks edged up in 1983 compared to an earlier year and a report out that said that the operating results for bank year 1982 to 1983 were equivalent to the period of 1970 to 1979.

So I wonder what it is that we are trying to do by the process of that deregulation as prescribed or authorized by Senator Proxmire's and Garn's bills and the others.

Mr. REGAN. I think first of all what we are trying to do is let the marketplace operate rather than have regulators say who should do what. The financial service industry has proved, particulary in the last 10 years, how creative it can be in coming up with new ways to satisfy demand for products.

INNOVATIVE FINANCING CONTINUES

There are any number of different ways of financing today that were not known 15 years ago or dreamed about 10 years ago. I would like to see this type of innovativeness continue. But Federal rules and Federal regulations get in the path of many of those things as time goes on.

Now, as each part of the financial services industry tries to expand into a different part of the financial services industry, if you will into someone else's backyard, you will find that usually prices come down.

Again based upon my experince on Wall Street, certainly the consumer has benefited from the discount broker. The discount broker wasn't permitted until we changed the regulation that said that commissions had to be fixed. The result is that bank holding companies and insurance companies and the like now own discount brokers. That being the case, rates, are coming down overall. Rates have come down for the largest traders, the institutions. Rates are now coming down for individuals. And certainly one other thing; they haven't been raised. Even if they haven't lowered, they haven't been raised although inflation would have called for price increases over the past few years.

I suspect that that is exactly what is going to happen to insurance rates, to bank rates, and things of that nature as you get more competition within the industry. The consumer will get more for less and be able to pick and choose a lot better among different products and firms.

Until the money market fund came along, which was a creation of a nonbank, certainly people did not get a justifiable rate of interest on the money they were trying to save. Federal regulations were impeding them. And had Federal regulators had their way, that situation never would have changed. If that innovation hadn't forced Federal regulators to change, nothing would have happened. Congress had to lead them by enacting the 1980 Deregulation Act.

So now you and I and everybody else are getting a market rate of interest on our savings. That's what I think and hope will come from deregulation within the financial services industry.

Senator LAUTENBERG. Mr. Secretary, the example of the brokerage industry is an interesting one, but I think here, in all due respect, that we are talking about an essential service. When we are talking about transportation and communication service and we talk about financial service, banking service let's say, I think we are talking about an essential industry.

And the result of the competition, and I agree with you in terms of the money market funds and other opportunities for investments, it has entitled the saver or the investor or enabled them to get a higher rate of interest. It has not helped, as we look at things today, with a very satisfactory decline in interest rates or inflation rates, rather. We still are looking at the highest real interest rate perhaps the country has known.

So when we talk about the individual consumer, we talk about the person who would like to get a mortgage on a home, an essential in the development of our country. That's not available under the same terms and conditions that used to exist. The fixed rate long-term mortgage is, in my view, on its way toward a continued decline.

Now, I understand about 45 percent of the loans are short-term variable rate mortgages. So things have changed. And I think the change is proper.

Senator Garn, in his opening statement, talked about the need for change as the times have changed. But the fact of the matter is that I feel that the brick and mortar that you referred to in your remarks, your prepared remarks, to me represented the contacts with the bank and the consumer; the "Hi, Fred; Hi, Joe. We know each other." And, "Hi, Mary," in these new days. The banker knew the consumer and the consumer knew the banker and they were able to do business.

There is no earthly reason why market forces would direct Citicorp, Bank of America, you named a lot of large entities and I am talking about simply the largest banks now. There's no reason why they are going to go to——

[To Senator Garn]. What's one of the counties here?

The CHAIRMAN. Summit County.

Mr. REGAN. I know Duchesne.

The CHAIRMAN. Shall I get him to pronounce Tooele, too?

Senator LAUTENBERG. The fact of the matter is the inducement just will not be there when the market forces are available. And I am concerned and I would not like to see things deregulated.

I, like you, have a great respect and appreciation and am a beneficiary to the best our private system has to offer. But the fact of the matter is over the years the banking system with its regulations has helped to build housing for lots of people and stability and build regional development.

I am concerned we are going to lose that opportunity as we get out to the marketplace and say, "OK. Here you go. Take the best deal you can get." And we are going to leave a lot of forgotten souls, in my view, in the process.

Mr. **Regan**. Let me try to respond to your concerns. May I start off by disagreeing with you as to what an essential industry is. I would submit that raising capital is an essential industry and that Wall Street and its investment banking firm is very essential. Otherwise why would we be worried about deficits? We are worried about crowding out. People won't be able to raise capital. I would submit that raising capital is an essential industry.

Real interest rates today, why are they so high? I think you don't have to look at anything except inflation and the money supply and the fear of what deficits might do in the future. Those are the causes of our high real rates of interest. It has nothing to do with whether our institutions are tightly regulated or loosely regulated, overly regulated or under regulated.

If the Federal Reserve eases up on the money supply, as some people thought they did a week or so ago, interest rates come down slightly. They went back up again. If the Fed tightens too much, interest rates go up because people fear there won't be enough supply to go around.

So a lot of what's behind the real interest rate is monetary policy. It has nothing to do with regulation or deregulation.

Now, as far as fixed rate mortgages and things of that nature are concerned, I call to our attention the dismal performance of the thrift industry in 1981 which culminated in 1982 with some, in my judgment, very foolish rescue attempts for that failing industry all because they had had fixed mortgage rates and fixed rates of interest that they were paying to their customers, and between the two they were in real trouble.

The variable rate mortgage seems to be, at least in an inflationary period, something that has more appeal for being able to benefit the thrift industry because rather than let them get into that vise between a fixed rate of interest being paid out and a fixed rate of interest being charged, it allows them to raise or lower their rates in accordance with market demands.

BANKING SYSTEM BASE SLOWLY ERODING

As far as the banking system itself being the backbone and the strength of the economy and financing, I agree with you, and that's what we are fighting for here—to make sure that the banking system is able to remain strong. If our banking system is not deregulated, if we hold it steady while people constantly chip at it, pretty soon it is going to fall of its own weight because its base will be eroded.

All of the other institutions are getting into the juiciest part of the banking business. They are picking it off. Investment bankers are doing it; brokers are doing it; insurance companies are doing it; thrift institutions are doing it. They are all chipping away at it. If the banks are not free to compete, I am afraid we are not going to have the type of banking system we had in the past or want in the future, which is a well financed and sound industry.

Senator LAUTENBERG. If I might just, to correct the record, I disassociated perhaps, to someone out of the field, there is no such thing as a nonlinkage between discount brokerage and raising capital. I think of discount brokerage as where shares are traded adding not necessarily to the market. So if you ask the question is capital raising essential, of course.

The CHAIRMAN. Just a couple of observations and remarks before we close this morning session of the hearing.

DEREGULATION NOT INITIATED IN THE CONGRESS

First of all, if you back up a little bit, Senator Lautenberg asked the proper question. Again, it's one that's been going through the theme all morning long of where this balance is and what deregulation is all about. I hope everybody recognizes that deregulation was not initiated in the Congress. Not by me or anybody else. Many of the issues have been kicking around before I even became a Senator let alone chairman of the Senate Banking Committee.

The market has changed dramatically. It would be very nice to go back to some point of time, if we went back to the point in time where I still had a full head of hair. You would also find that's far enough back that you would find that banks were in the commercial lending business. That Merrill Lynch was in the securities business. Sears was selling sewing machines, clothes, and furniture and thrifts were in the mortgage lending business, and real estate companies were in real estate and all of that.

Congress, in many of those changes, has not precipitated those changes. Those have occurred in the marketplace for a lot of reasons; technology, computers for one. It made possible exchanges of money that couldn't have been handled, bookkeepingwise, a few years ago. Many of the issues were not an issue because you couldn't do it. It was not possible.

Merrill Lynch couldn't operate the way they do today. You can go up to the office and see all that spew out on the CRT tube.

My business, insurance, I had to wait weeks for proposals in the U.S. mail. I could now get proposals back with more information than you knew existed before. So the change developed as a result of all the marketplace changes that the users found through the financial institutions and the traditional depository institutions were so heavily regulated. They could have 5¼ or 5½ percent. There were geographic provisions. There were reserves that were in the form of another tax.

Then you found the innovation of people like the chairman of Merrill Lynch and others. They invented CMA's and cash management and relation with Bank One in Ohio, and all kinds of innovations that I don't criticize. They found better ways to serve their customers.

But you approach this in a dramatically changing marketplace and there were two ways to go. This occurred very dramatically.

There was a battle over S. 124 in the Utah State Senate and Legislature a few years ago over this very issue. There was an attempt to say the way to solve this problem is to tell Merrill Lynch and all the people coming in and finding new ways to serve without the same restrictions, we were going to tell them they can't do it. I am obviously overgeneralizing and that bill failed.

And so you could make a choice at the national level. You could say you can't have people doing the same services with different sets of rules and that is what I fundamentally subscribe to. If you are going to provide the same service or product, you better be treated the same not because of your brick and mortar institution or where your headquarters happens to be.

You said, "All right. We will try to put geographic restrictions on Merrill Lynch and Sears and reserve requirements and that kind of thing and that will be equal." And it would. But that was not possible. You could not put the Government in that ball game and say, "You can't do those things." There would be an uproar.

You should have seen my mail as a result of the Utah Legislature with which I don't have anything to do. Letters said, "Don't let them do one thing that reduces my interest rate. Don't take that 15 percent away and force me to have a 5¼-percent account."

The only logical way to go was to try to remove some of the shackles on the traditional institutions and particularly interest ceilings. What sense did it make for Government to say, "You are a free enterprise institution but we placed a law that says you cannot pay more than 5¼ percent to your depositors." What sense did it make when the market was at 15 percent? I think we need to put this deregulation into perspective as to which came first, the chicken or the egg, and ways it's coming about.

The second observation I would make is I don't think anybody will ever push the small local entrepreneur out of business. In 1982 California, with Bank America, the biggest financial institution in the country, there were more new banks and savings and loans chartered in 1982 than in any year in the history of the State. Right with Bank America. Just chipping away and taking business away from them because they could provide a level of personal service that that big, impersonal institution could not provide. "I knew your father before you and your grandfather. You don't meet the credit guidelines, but I know your family is good for it. So you get the loan."

Walter Wriston, of Citicorp, testified last fall when asked how did Citicorp do when they left New York City and went to upstate New York, he said, and these aren't the exact works, "They cut off my head and put it on a silver platter and sent me back to the city." Citicorp failed in the rural areas of New York. They did not compete and the smaller institutions are thriving. That's pretty clear across the country. Small institutions, insurance, banks, savings and loans, in this so-called new marketplace are surviving very well. As a matter of fact they are increasing in size.

But it's something that is being pushed on us and we could take the attitude that we will sit back and let the marketplace go and have unfair competition created by Government or we can try and remove some of the shackles that were imposed before computers were ever available and the technology available to make all of those transfers instantaneous.

So that's where the Banking Committee is coming from in taking a look at this situation. As Senator Lautenberg has pointed out so well, the difficult thing comes in deciding where that balance is and that's what these hearings are all about; to attempt to determine where that fair or middle ground is. It's not an easy question. It's not easy at all because everybody wishes to hold onto their own.

For the last 3 years the testimony is, "We love the part of the bill that does something for us. But to hell with everybody else that doesn't do something." You have to go through a process of consensus and give and take and try to achieve some balance so that no segment of the financial services industry is being given an inordinate competitive advantage as a result of Government regulation.

As I have said before, taking advantage of our former position, if Merrill Lynch under the same rules can put a bank out of business, so be it. Or if the bank can put Merrill Lynch out of business, so be it. That's fine, but not if Government is imposing different types of rules.

REGULATION BY FUNCTION, NOT BY TYPE OF INSTITUTION

An issue we did not provide and has not been reported and is not in this bill is one of extended type of regulation. Chairman Volcker touched on it briefly. He is jealous of his regulatory powers at the Fed and to quote him I drive him up the wall every time I talk about taking the Fed's regulatory power away from him. But I see no reason why we should have a Comptroller, the FDIC, the Fed, all the different agencies regulating the same types of functions.

In the Tennessee bank failure situation there were 11 different regulatory agencies involved in it. That's one of the reasons they got away with it so long is there was so much duplication between the regulators that they were able to fit in the cracks between them.

I am not one who favors having one super bank or securities regulator in this country. That's too much power. But we have far too much overlap and duplication as it exists today. So I don't know when the Bush Commission is going to finish the report or what they are going to recommend, but it seems to me in looking at this, once we have made a decision on what kind of powers and authorities institutions should have, then it makes sense that there be equity in regulation and that we look at regulation by function and not by type of institution.

In other words, if Merrill Lynch is in the securities business and Sears is in the securities business and a bank is in the securities business, those functions ought to be regulated by the SEC so that they are competing under the same rules and regulations.

If a bank is in the banking business and Sears gets into the banking business, there should be a banking regulatory commission under the same rules.

Something we have not discussed is the diversity of regulation where people get competitive advantages selling the same product because they may be treated more leniently. Regulation laxity has been referred to. We are going to have to address how we regulate the function and I lean more all the time to regulation by function so you have equity rather than by the type of institution you happen to be called.

Before we close, do either of my colleagues have questions or comments you want to make?

Senator LAUTENBERG. I did take too long to get on the subject to get off the subject so I cancel myself.

The one comment I wanted to make to the Secretary was talking about the revenue increases that has taken place over the year, fairly substantial. The point of the matter is without being the subscriber for higher taxes to accompany increased spending, I would like to curtail spending and I think there are many ways to do it. Senator Garn and I might differ on a thing or two but we do see things largely in the same picture.

I do want to point out that revenue increases, although they have increased substantially, did not increase for instance under the corporate sector and that is not, Mr. Secretary, as you know, simply a product of the lack of economic activity. What has happened is corporate contributions to the Internal Revenue Service, if I can put it that way, were reduced to something less than 13 percent.

Mr. REGAN. It will be 10 percent.

Senator LAUTENBERG. And there is something amiss there. I respect your concern about closing some of the loopholes, et cetera.

THE BUSH DEREGULATION COMMITTEE

Mr. REGAN. Two quick comments, Mr. Chairman, if I might. The Bush Deregulation Commission, which I happen to be Vice Chairman of, is having a meeting later this week. We hope to come up with some type of general agreement among all of the agencies concerned with regulation of financial institutions. I would say at this moment we are about 80 or 85 percent of the way. We have some last few subjects which will be thrashed out hopefully later this week. And then the writing of the report should commence. We hope to get it to the Congress early in this session. We would recommend, though, that you not come up with any restructuring of the regulators until such time as you settle on this particular bill so that we know exactly what the powers are that are going to be regulated.

We think that makes more sense, even if it necessitates waiting for another session of Congress to get to the question of the regulators themselves, depending upon how successful you are on the product deregulation bill.

The CHAIRMAN. I agree it makes no sense at all to put the cart before the horse, to decide on deregulation if you don't know who is doing what.

Chairman Volcker, and I didn't have the chance to ask today, he said if they were tied together he would oppose the whole package, and I agree. That's why there is no reference to deregulation. We have been awaiting the outcome of the Bush report before starting the report. They have to go in a sequence. So we don't disagree on that.

Mr. REGAN. A final comment just so you don't think the Chairman of the Fed is the only one who gets jealous. The Comptroller of the Currency does report to the Secretary of the Treasury. At one time the OCC was lodged completely within Treasury. But the

OCC was taken away from the Treasury years ago. The OMB—its budget functions—were taken away from Treasury also. The Coast Guard was taken away. But I think you follow.

The **Chairman**. Are you closing up shop?

Mr. **Regan**. If we have nothing else to do, we can close up shop.

The **Chairman**. Let me thank both of my colleagues for being here. Let me thank the Secretary for his efforts and I might inform you he may be staying longer than he wants. The airports in Washington are closed. So you may have to to stay. We may have to arrange for some skiing or something back to Washington.

Mr. **Regan**. That would be a distinct pleasure but at this time I'd just as soon take a rain check.

The **Chairman**. May I announce that the hearing will convene in this room at 2 p.m., and I would encourage all of you to come back. I realize we have had the bigname witnesses this morning, with all due respect. But we have some fine local witnesses this afternoon and that was the primary reason of holding this hearing here, because often our witnesses around the country do not get the opportunity. We get one representative to come back.

We will hear from some of our State regulators this afternoon as well as representatives from the various industries we have talked about who live here in Utah.

So I would encourage all of you to come back at 2 p.m. Thank you very much.

[Whereupon the morning session adjourned at 12:20 p.m.]

AFTERNOON SESSION

The **Chairman**. The committee will come to order.

We are pleased to have as our first witness this afternoon, Elaine B. Weis, commissioner for the Utah Department of Financial Institutions. I'd like to compliment Elaine and Roger Day, who is our commissioner of the Utah Department of Insurance. Although we work at different levels of government, both of them have been very cooperative with me and the Senate Banking Committee and working jointly on some issues of mutual interest. I want to thank you both for your willingness to testify but almost more importantly for your very close cooperation with me and my staff as we have worked on these issues.

Elaine, would you like to begin.

STATEMENT OF ELAINE B. WEIS, COMMISSIONER, DEPARTMENT OF FINANCIAL INSTITUTIONS, STATE OF UTAH

Ms. **Weis**. Thank you. On behalf of Governor Matheson and myself I would like to welcome all of you to Utah. I wish we could offer better weather.

Senator **Lautenberg**. I'm satisfied.

The **Chairman**. Under the issue of weather, I'm chairman of HUD. It has some independent agencies and one of those is the National Science Foundation. For 3 years they have been trying to get me to go to Antarctica to see how they spend the money. I went on the junket to the southern climes. Not too far south. It was 39 degrees below zero with a wind chill factor of about 60 below.

But in any event, at the South Pole I didn't know this but you land on skis at 10,000 feet elevation and it is all snow. It is literally 2 miles deep. I saw a T-shirt that said, "Ski the South Pole. 10,000 feet of base and a half inch of powder." So we don't have much snow up at our resorts.

Please continue, and excuse the interruption.

Ms. **Weis**. It is a privilege to be given the opportunity to present my views on S. 2181, the Financial Services Competitive Equity Act of 1983 and S. 2134, the Depository Institutions Holding Company Act Amendments of 1983. I commend the members of the committee for their courage in addressing the difficult and controversial issues of banking deregulation in the midst of the ferment of change rather than following the easier courses of passing a moratorium or allowing the market to continue to evolve in a disorganized fashion. Now is the time for Congress to determine the legal framework which will govern the financial marketplace of the future. The system may not be broke, but it has run amok. It may not need fixing, but it definitely needs redirection.

As the primary regulator of all State-chartered financial institutions in the State of Utah, including 53 commercial banks, 11 savings and loan associations, 186 credit unions, and 37 thrift and loan companies, I am concerned about the inability of the existing regulatory structure to accommodate market developments and at the same time maintain the safety and soundness of the financial system.

REAFFIRM STANDING COMMITMENT TO THE PROTECTION OF DEPOSITORS

My department deals with all of the Federal financial institution regulatory agencies involved with financial institutions. Historically, we have maintained a close working relationship with them based on the common goal of maintaining the integrity of the Utah financial system. However, over the past 18 months there appears to us to be an increasingly cynical attitude among the Federal regulators that the failure of a regulated institution is of little consequence to the community. The State of Utah does not share this belief. The policy of our State and the legislature is that the primary role of financial institution regulation is to protect the citizens and to maintain public confidence in the safety and soundness of the State's financial system. I urge this committee and the Congress to reaffirm their longstanding commitment to the protection of depositors.

Although both S. 2181 and S. 2134 deal with a number of different issues, I would like to address my comments to the two provisions of both bills that have a direct impact on the Utah scene. The first is the definition of a commercial bank. Chairman Volcker discussed that rather extensively this morning.

In Senator Garn's bill there is a definition which I feel is much more appropriate. It closes the nonbank bank loophole but it does recognize the legitimacy of State-regulated institutions which have been in existence not to circumvent the bank holding company act and not to circumvent regulation, but to serve the citizens of the State. That industry in Utah locally is called the thrift and loan. It has been part of the Utah financial scene for over 50 years.

The first thrift and loan was chartered in 1924, long before the Bank Holding Company Act was passed and before the Federal Reserve had as involved a role in regulation. It served Utah citizens for this period and it has provided an attractive alternative to the traditional depository institutions. In fact, in the last few years deposit in thrift and loan companies have increased at a far more rapid rate than either banks or savings and loans. In the last year deposits in thrift and loans increased over 30 percent. In several areas, such as minimum capital requirements, lending limits, and affiliated transaction, the laws and regulations governing thrift and loan companies are more restrictive than those governing banks or savings and loan associations.

In fact, the Federal Deposit Insurance Corporation has reviewed our statutes and regulation and has ruled it is comparable to banks and granted FDIC insurance to the first applicant in the State.

RECOGNITION OF INDUSTRIAL LOAN CORPORATIONS AS NONBANKING INSTITUTIONS

S. 2181 recognizes the legitimacy of industrial loan corporations as nonbanking institutions, S. 2134 does not. Not, as Chairman Volcker says, because they engage in both the acceptance of transaction accounts and making of commercial loans, but through the inclusion of the institutions eligible for FDIC insurance as a bank.

Now, I have difficulty understanding the rationale that any institution eligible to apply for FDIC insurance automatically becomes a bank. They would perhaps more accurately be characterized as possible potential banks. They are not banks by charter or regulation and to classify them as banks through eligibility, I feel, extends the definition beyond what is proper or appropriate.

If the definition proposed in S. 2134 is adopted, these industrial loan corporations would become banks for bank holding company purposes. Since most of Utah's thrift and loan companies are owned by holding companies, which are also regulated by the State, these companies would become bank holding companies and would be subject to all the restrictions and regulation that such a designation entails. As a result, many of Utah's thrift holding companies would be required to divest themselves of their subsidiary thrift and loan companies. I'm not quite sure who they could find to purchase them. In addition, the classification of thrift and loan companies as banks would make it extremely difficult for the commissioner to find satisfactory solutions to problem institutions.

We have had several situations in the last year where we were able to successfully negotiate acquisitions of problem institutions. If these institutions were banks for bank holding company purposes, I doubt that we would have been able to resolve the problems as we did and this would result in hardship and loss for the citizens of the State.

I have yet to hear, either in the testimony today or in any of the written materials that I have reviewed, any economic or public interest objective that has been put forth that could justify the destruction of an industry within a State and which has performed a legitimate function within that individual State's economy.

The second major provision of both bills that will cause difficulty in the State of Utah is the requirement that all newly authorized banking powers be exercised by holding company subsidiaries instead of directly by the bank or by a bank subsidiary. In my written statement submitted to the committee I have set forth a lengthy discussion of the reasons for my opposition to this provision. But I'd like to summarize those.

DISCRIMINATION AGAINST SMALL BANKS

First, such a provision discriminates against small banks and when we are talking about small banks in a State such as Utah, and frankly in most States, we are talking not about banks under $500 million. We are talking about banks $20 million, $10 million. The administrative costs and the additional regulatory burden of forming and operating a holding company in many cases are simply not going to be justified by the profits anticipated by the new activities that they would enter into. The community banks play a vital role in States such as Utah in providing credit to small businesses, consumers, and small farmers. Such a requirement that these institutions diversify only through a holding company is going to place them at competitive disadvantage vis-a-vis the larger banks.

In Utah, our law which has been on the books since 1981 is exactly the opposite of the proposed statute. The Utah law grants banks all 4(c)8 powers, all powers of national banks and all powers of bank holding companies under the nonbanking provision. A number of our State-chartered banks have exercised this authority and we have no evidence, nothing that would lead us to conclude that this has exposed the bank to greater risk or been to the detriment of the depositors.

The second point is expanded banking activities such as real estate, insurance and securities brokerage, leasing, consulting and other sales and service functions do not entail any greater degree of risk than the traditional lending function. Insurance and securities underwriting and real estate development, however, are more speculative and risky operations. Therefore, if any activities should be separated from the bank itself, it should be only those where there is sound empirical evidence that there is significantly greater risk to depositors.

The third objection is that the holding company form of organization does not insulate the bank from whatever risk may be incurred by engaging in expanded activities, particularly for the small- and medium-sized bank. Bank holding companies with consolidated assets of $1 billion or more are able to tap the national market. However, small institutions do not have that privilege. Their only source of funds for expanded activities is through borrowing from mainly other banks and pledging the security of the subsidiary bank's stock. Forcing a bank holding company to incur more debt to fund new activities which could be offered by a well capitalized and managed subsidiary bank does not protect the bank, but exposes the bank to greater risk.

If the experience that we have had in this State would lead me to conclude that the existing holding company regulation was an effective regulatory system, perhaps I would not feel as strongly about the requirement of forcing activities to be done through holding companies. Unfortunately, with our experience we have found that regulation of the holding company has not prevented the insolvency or potential insolvency of a bank holding company. I find it hard to believe that more activities in the holding company will result in better supervision of the holding company thereby protecting them.

I have been handed a note that my time has expired so I'd like to summarize. The last comment is that one of the objectives of permitting banks to expand their activities is to provide an alternative source of earnings to interest income. With interest margins at banks shrinking due to the phaseout of regulation Q ceilings, banks must seek new profit opportunities.

I think that the statistics you will find will show a significant decrease and if you look at the prices of public and trade banking companies, even those that aren't involved in sovereign loans you will find that they have declined because of lower earnings projections. Profits earned by a bank holding company subsidiary cannot accrue to the benefit of the affiliated bank. Unless they wish to adopt some strange regulatory accounting, this can never really benefit the earnings of the bank and can never serve to strengthen bank capital. The restriction of bank holding companies is the restriction of service corporation activities. In Utah our savings and loan service corporation power is quite a bit broader than that permitted by Federal authorities and in my opinion it is one of the reasons why our savings and loans in Utah have not experienced as great a financial difficulty as have their counterparts in other States.

Those institutions that expanded through the State authority into profitable activities have maintained their profitability even through 1981 and 1982. This proposed restriction not only preempts what we feel has been an effective State law that benefits the State and the institutions but it appears to be contrary to the intent of the Garn-St Germain Act.

Perhaps the most disturbing aspect as a State regulator of the proposed bill is I feel they seriously undermine the effective functioning of the dual system of regulation. I imagine it's a philosophical issue, whether the dual system of bank regulation has a role in an integrated financial system. But I feel this is an issue that must be addressed directly by the Congress, not back doored through an erosion of State authority, the preemption of State, laws, and the imposition of additional regulatory burdens on not only the institutions but on the State authorities that are trying very hard to resolve the problems.

EFFORTS TO SOLVE PROBLEMS THWARTED BY FEDERAL REGULATORS

I have found it particularly discouraging as a State regulator to work very hard in adopting regulations and having laws passed and implementing those only to be thwarted in efforts to solve our problems by the procedures and attitudes of Federal regulators.

If I might give one example, not naming the Federal regulator, in a situation in which we had had an institution closed for 5 months and in which depositors could not obtain their money. The assets and the deposits were frozen. It was right before Christmas and we asked for exigent treatment from the relevant agency. Their comment was, "It's been closed for 5 months. What's another 15 days?" I found that offensive and rather insensitive to the needs and the hardship of the people.

In closing, I strongly urge the committee to reject any proposal that mandates forming a holding company form of organization. I hope any new legislation is flexible enough to accommodate the different systems that have evolved under State law and which are functioning effectively without undue risk. There has been a dual system. Different States have evolved different systems. If there are abuses, address the abuses but don't adopt policies which throw out the good law along with the bad.

Thank you again for this opportunity to present our views and I'd be happy to answer any questions you have.

[The complete statement follows:]

WRITTEN STATEMENT TO
THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
OF THE
UNITED STATES SENATE

BY ELAINE B. WEIS, COMMISSIONER
DEPARTMENT OF FINANCIAL INSTITUTIONS
STATE OF UTAH

JANUARY 16, 1984

Mr. Chairman, distinguished members of the Committee, it is an honor and privilege to have the opportunity to present my views on S. 2181, the Financial Services Competitive Equity Act of 1983 and S. 2134 the Depository Institution Holding Company Act Amendments of 1983 and other issues involving the deregulation of the financial services industry and the appropriate role for the various regulatory agencies in a deregulated environment. As Commissioner of Financial Institutions for the State of Utah I am responsible for the regulation and supervision of all state chartered financial institutions in the state including 53 commercial banks, 11 savings and loan associations, 186 credit unions and 37 thrift and loan companies, which are depository industrial loan corporations. As chief regulator of these diverse providers of financial services I have been in a unique position to evaluate the impact of deregulation, increased competition from both traditional and non-traditional financial services companies and the inability of the existing regulatory structure to accommodate market developments and at the same time maintain the safety and soundness of the financial system. I commend Chairman Garn, Senator Proxmire and the members of this committee on their courage and responsibility in addressing these critical issues rather than imposing a moratorium or simply responding to market demands. Now is the time for Congress to determine the legal and regulatory framework which will govern the financial marketplace. The system may not be broken, but it has run amok; it may not need fixing, but it definitely needs redirection. Too much time, money and resources are being wasted in devising complex schemes to circumvent the system which could be more profitably employed in delivering financial services to the public.

In any consideration of the proper statutory and regulatory structure for the financial services market, the fundamental objectives of government regulation should be the primary guiding principal. The public purpose financial services regulation system is to protect the interests of the public and the right of American businesses and individuals to have a financial system which provides access to credit at fair prices, a reasonable return on funds deposited with financial intermediaries and an assurance of the safety of those deposits. Any reforms which are enacted by Congress should enhance the ability of well-managed financial institutions, regardless of size, portfolio mix, type of charter or location, to meet the needs of the public efficiently and effectively. The goal of regulation should be to assure the safety and soundness of the financial system with a minimum of intervention into the business decisions of well-managed firms. Changes in the legal structure governing the financial services marketplace that facilitate competition among various financial services firms and that reduce the inefficiencies and costs of regulatory oversight will improve the efficient operation of the market.

The maintenance of public confidence in the safety, soundness and stability of the financial system is a necessary prerequisite for the efficient functioning of the diversified, decentralized system of privately owned financial institutions which we have in the United States and which has played such a vital role in the economic growth of this country. In the last year, in my judgment, a disturbing trend has emerged. High level financial industry regulators appear to support a position that the business and market risk of financial intermediation should be shifted from investors to depositors. In Utah, the Legislature and the Administration do not share this view. Our laws and regulations acknowledge that citizens do not perceive deposits as investments. A person who deposits money in a regulated financial institution expects those funds to be available; he does not consider that his deposits are at risk. Until recent years it has been public policy to foster this confidence through the safety net of deposit insurance and government regulation.

In Utah we have adopted the policy that the primary role of the regulator is to protect Utah citizens, thereby insuring the stability of the system. During the last year we have found that the policies of the various federal regulatory agencies with which we coordinate our regulatory functions have diverged from those of the state. There appears to be an increasingly cynical and callous attitude that it is not important to find solutions to troubled institutions and that the failure of a regulated institution is of little consequence to the community. We view this transformation with alarm and urge that the committee and the Congress reaffirm its commitment to the protection of depositors.

In addition to deposit insurance and federal regulation of depository institutions, Congress has determined that depositors are best served by dividing financial services into arbitrary categories of risky and risk free activities. There has been considerable testimony before this committee and other public bodies as to the necessity of preserving the separation of banking and commerce. But what constitutes banking in the modern world? The heated and emotion charged arguments and detailed legal treatises which revolve on this fundamental question have occupied much of the attention of regulators, legislators and the various industries which provide financial services. However, in my opinion, this is not the central issue. Banking is quite simply the function of financial intermediation, that is collecting funds from one set of persons and lending or investing those funds with another set of persons. Commercial banks, savings and loan associations, credit unions, industrial loan companies, finance companies, insurance companies and securities companies all perform the banking function to some extent. The differences among these various financial intermediaries reside in the characteristics of the primary suppliers and users of the funds they intermediate and the instruments utilized to accomplish the intermediation function.

Therefore, if many classes of firms perform the banking function, what distinguishes a bank? This is the very question which both S. 2181 and S. 2134 address in the initial sections of both bills. In my judgment, the definition provided in Senator Garn's bill is superior to that proposed by Senator Proxmire because it acknowledges the fact that the most significant distinguishing characteristics of a bank are that it is insured by the Federal Deposit Insurance Corporation and engages are in the business of making loans to businesses and other commercial enterprises. The mere eligibility for Federal deposit insurance does not make a financial intermediary a bank.

Perhaps a firm which is legally eligible to become an insured bank could best be categorized as a possible potential bank.

The adoption of the broader definition of a bank included in S. 2134 would have a significant negative impact on the Utah financial industry. For 30 years industrial loan corporations have operated in our state and have provided the public with an alternative to federally insured depository institutions. A significant body of state law and regulation has been adopted to insure the safe and sound operation of this class of depository. The adoption of the broad bank definition in S. 2134 would preempt state statute and regulation without sufficient public interest justification and would leave an entire industry in an untenable situation. Utah's industrial loan corporations would have all of the disadvantages of a bank with none of the advantages. Under state law, they could not even call themselves banks. Most of the depository industrial loan corporations in the state are owned by holding companies, which would become bank holding companies as a result of the adoption of the S. 2134 definition. Many of these holding companies would be forced to divest themselves of their industrial loan corporation subsidiaries because of Douglas amendment prohibitions against the interstate ownership of banks or because the holding company's primary business is not that of a bank, but of another line of commerce.

The congressionally mandated destruction of an entire industry which holds over $400 million in deposits of Utah citizens can hardly serve the public interest. On what basis should a federal regulatory agency assert jurisdiction over an institution created and authorized by the legislature of an individual state which is not insured by a federal agency but is only legally eligible to apply for insurance? The Federal Reserve has asserted that the extension of its authority over non-federally insured state chartered depository institutions is essential to effective monetary control, however, monetary policy is implemented through the management of reserves, not through regulation and supervision. Unless and until the Congress has determined that it is essential to the national interest to eliminate the dual system of financial institution chartering and regulation, federal supervisory authority should be restricted to those institutions and activities properly within their jurisdiction.

I would also like to support S. 2181's statutory restriction of the activities which may be classified as a commercial loan. In a recent amendment to Regulation Y, the Federal Reserve adopted a definition of a commercial loan which encompasses virtually every investment and extension of credit not made to an individual or a charitable institution. Surely the intent of defining a bank as an institution which both accepts demand deposits and makes commercial loans was not to include debt instruments such as bank deposits. In my judgment, S. 2181 quite properly establishes parameters consistent with the economic nature of the commercial lending function within which the federal authorities can define commercial loans. I would encourage the Committee to consider the inclusion of a similar statutory definition of a demand deposit to settle this controversial issue.

The central emphasis of both bills before the committee is the authorization of bank holding companies to expand their activities into a broader range on non-banking activities. There has been some disagreement among the federal regulatory authorities as to the means of facilitating the diversification of bank asset powers. I am disappointed that both bills have elected to endorse the Federal Reserve Board's program in lieu of the direct diversification of the investment authority endorsed by the Comptroller, the FDIC, and the Federal Home Loan Bank Board.

The basic premises upon which the requirement that non-banking activities must be performed solely in holding company subsidiaries appear to be that it is necessary to strengthen the barrier between financial intermediation and the provision of other goods and services and that non-banking activities are inherently unsafe and unsound. The simple fact is that most of the proposed activities such as real estate, insurance and securities brokerage, leasing, and consultant services are no more risky than the traditional business of banking and may actually involve a significantly lower degree of risk in a volatile interest rate environment.

There is no empirical evidence to support the argument that a diversification of activities within a regulated depository institution has undermined the safety and soundness of the institution and has exposed it to a higher risk of failure or insolvency. Well managed firms can be expected to manage non-banking acativities with the same system of responsible decision making that is employed in managing traditional banking functions. The bank and savings and loan failures which have occurred over the last two years have not been due to the diversion of institution resources into non-banking activities, but to the failure to adequately manage the traditional functions. Any abuses which could occur as a result of the expansion of direct bank investment authority can be dealt with adequately through normal supervisory and examination procedures.

Arguments have been made by both the Treasury and the Federal Reserve that restricting the expansion of investment authority to holding company subsidiaries preserves the separation of banking and commerce and insulates the subsidiary bank from whatever additional risk may arise from entry into new areas of business activity. However, in reality, these desired goals simply cannot be achieved. Is it reasonable to assume that an insured banking subsidiary whose holding company faces imminent insolvency will remain aloof, serene and unaffected by the parent's financial difficulties? Despite the Federal Reserve's attitude that the bankruptcy of a holding company would have no significant negative impact on the subsidiary bank, the two are inextricably interrelated. I regret that I can testify personally that the existence of a holding company does not insulate the bank from risk, but in fact, may expose it to even greater risk.

Perhaps an example will illustrate my point. Let us assume that the Utah Bank Holding Company ("UBHC") is organized by ten individual investors, each of whom contribute $50,000 as initial capitalization. UBHC acquires Utah Bank ("U Bank") in a leveraged buyout for $2,500,000, borrowing $2,000,000 from a lender at 12% interest on a 15-year note, interest only for five years, and amortized quarterly thereafter. The financial statements of U Bank and UBHC are as shown below at the end of the fifth year of operation.

U Bank

Assets	Dollars in Thousands	Liabilities	Dollars in Thousands
Cash & Due from Banks	$ 3,000	Deposits	$ 45,000
Securities	5,750	Other liabilities	2,000
Gross Loans	40,000		
Less Loan Loss Reserves	250	Total Liabilities	$ 47,000
Net Loans	$ 39,750	Equity Capital	3,000
Bank Premises	500		
Other Assets	$ 1,000		
TOTAL ASSETS	$ 50,000	TOTAL LIABILITIES & EQUITY CAPITAL	$ 50,000

UBHC (Unconsolidated)

Cash & Due from Bank	$ 200	Notes Payable (12%)	2,000
Premises, FF & E	150	Other Liabilities	200
Investment in Subsidiary Bank	2,500	Equity Capital	750
TOTAL ASSETS	$ 2,950	TOTAL LIABILITIES & EQUITY CAPITAL	$ 2,950

Annual debt service required to service the UBHC debt for 10 years at 12%, amortized in 40 equal quarterly payments of $86,524.75 each is $346,099 per year. U Bank has been earning an average 17% return on equity, which has enabled the bank to pay dividends to UBHC sufficient to cover its debt service requirement. However, in 1983 U Bank's nonperforming loans have increased, and its cost of funds has risen, with a commensurate decline in earnings. Projections for 1984 indicate that U Bank will be unable to pay any dividend to UBHC. In fact, it is highly likely that Federal and State regulators will require recapitalization of the bank.

The UBHC cannot service its existing debt and it is unlikely that it will be able to incur more debt to recapitalize U Bank. What are its options? The only option available to UBHC is additional equity investment by existing or new stockholders. Otherwise, UBHC will default on its debt obligation within the next year, placing both U Bank and UBHC in jeopardy. This example illustrates how the existence of the holding company greatly increased the risk exposure of the subsidiary bank.

Because of the negative experiences we have had in Utah with bank holding companies, I am strongly opposed to the proposition that any new activity authorized for banks be offered only through a holding company affiliate. If the new activity fails, the holding company form of organization will not protect the bank. In fact, it may expose the bank to greater risk, since the loans made to a small holding company are generally secured by the stock of the subsidiary bank. Holding company directors will put pressure on bank directors to dividend up income adequate to cover holding company debt service and operating expenses, thereby weakening the capital position of the subsidiary bank. Banks which lack earnings to pay dividends will be induced to upstream so-called "management fees" to the parent far in excess of the value of services received.

Concern has been expressed about the misuse of insurance of accounts to obtain funds to invest in new activities outside traditional banking functions. The concern could be addressed by imposing further restrictions that if a bank eligible to offer new services through the bank or a bank subsidiary elects to do so, it must 1) restrict the aggregate of its investment in subsidiaries to a certain percent of assets, perhaps 10% or 20%, and 2) maintain unconsolidated bank capital at a higher level than that required for an undiversified bank. If the bank determines that it is in its best interest to invest a greater amount in non-traditional activities, it will be required to offer the service through a holding company affiliate.

While the greatest concern has been expressed for the downside risk of new ventures, little attention has been paid to the upside potential. If diversification of permitted bank activities is argued on the basis of providing banks with alternative sources of income to compensate for the loss of net interest income due to removal of interest rate ceilings on deposits, then it makes no sense to mandate a structure which precludes the profits from new activities from being included in bank profits. Through the holding company form of organization, profits would be upstreamed in the form of dividends to the parent. The subsidiary bank could only benefit if the parent contributed more capital to the bank. The profits from affiliate activities could never be reflected on the income statement of the bank. As a result, banks could be left with only the least profitable and potentially the most risky activities due to the volatility of interest rates. The result would not be greater protection for the banking system and the FDIC, but greater risk and potential for loss.

Another argument which has been put forth in favor of the holding company solution is that the holding company strengthens the subsidiary bank through better access to the capital markets. While this may have some validity for large banking organizations, it is simply not true for the small bank holding company. My staff conducted a very cursory survey of the minimum asset size for a bank holding company to participate in the organized capital markets. Four major investment banking firms which are active in the bank securities market and the research staff of the Federal Reserve Bank of San Francisco indicated that one billion dollars in assets would be the approximate lower limit for participation in the national capital markets. Attached is a summary of the responses received and a copy of the research paper drafted by the San Francisco Bank.

The requirement that new investment authority be exercised only through the holding company form of organization discriminates against the small banking institutions which predominate in Utah and most other states and which perform an essential function in providing capital to small businesses, consumers and small communities. I do not share the view that small banks are economically inefficient and managerially unsound and are doomed to extinction in a deregulated environment. Success is not a function of size, but the quality of management. Mandating the structure of a bank's organization not only inteferes with sound decision making, but also imposes an unjustified increase in administrative and overhead expense and, in the case of the independent non-member bank, imposes another layer of regulation through one more regulatory agency. The additional capitalization and the increased administrative burden of adopting the holding company form of organization may not be justified by the anticipated benefit of entry into new activities. As a result, Congress's action could place community banks at such a competitive disadvantage that they may be unable to survive. The result would be the concentration of financial resources which has been regarded as against the public interest and the depriving of small communities of locally owned and operated financial institutions.

In conjunction with the requirement that deregulated activities be conducted through a holding company, S. 2181 drastically limits the permissable activities of savings and loan service corporations. The effect of these new restrictions would be to force savings and loan associations to form a holding company in order to offer diversified financial services to their customers. If adopted, this proposal would deprive savings and loan institutions in many states, including Utah, of the opportunity to engage in profitable activities which will improve their earnings and strengthen their capital position. Under Utah statute, a savings and loan can invest 10% of its assets in a service corporation subsidiary which is permitted to engage in any financial service activity. In addition, the association can invest an additional 10% of its assets in a service organization which is restricted to the types of activities enumerated as permissable service corporation activities in S. 2181. Mutual savings and loan associations would be even more severely restricted. For a mutual savings and loan association to engage in expanded activities to any meaningful extent it would be forced to convert to a stock association and then form a holding company. I cannot perceive any economic or public policy justification for such a statutory requirement.

As a state regulator, the most disturbing aspect of the proposed bills is that they seriously undermine the effective functioning of the dual system of regulation that Congress, if not the federal regulatory authorities, up to this point has determined to be in the national interest. In fact, in most instances there is no acknowledgment of state authority whatsoever. It is most discouraging as a state regulator to work diligently to have laws and regulations adopted to protect the interest of the citizens of the state and to foster the safety and soundness of the financial institutions under your jurisdiction only to have the federal regulatory authorities and Congress itself totally disregard the concerns of the individual states. Of course, it is Congress's prerogative to override state statute where it conflicts with the public interest. But to adopt a law which eviscerates the state system, without consideration and debate over the public policy implications of such an action appears to me to be irresponsible. Congress should take this opportunity to define and articulate the public policy objectives of financial services industry regulation. What public benefit is the structure expected to achieve? How much risk should the public assume? How can the regulatory structure be improved to preserve the integrity of the system without adding to the cost of regulation? The essential objective of any new legislation is to develop a regulatory system which can function effectively within the economic and market framework of increased competition and diversification of products and services. Specific benefits to and restrictions on classes of financial services companies should flow in a rational manner from the underlying public policy objectives. In my judgment the rational approach to restructuring of the financial system is to provide all classes of financial intermediaries with a broader range of investment authority rather than limit existing diversification available to some classes of institutions. Stringent and enforceable restrictions should also be placed on related party transactions to avoid conflicts of interest. The criteria for a depository institution to enjoy the benefits of federal deposit insurance should be clearly set forth in federal law and regulation.

I strongly urge the Committee to reject any proposal which increases reliance on the holding company form of organization. Instead any new legislation should establish a system which leaves the decision of the structure of the financial services delivery system up to the management of individual institutions. There is no public interest benefit which could possibly be achieved which would offset the negative impact of a law which discriminates against small and mutually owned institutions and which undermines the very foundation of the dual system of regulation which has served the nation well for the last fifty years. If some restriction on diversification of investment authority within an institution or through a subsidiary is deemed necessary, let that restriction be based upon the adequacy of capital to support greater risk and the degree of portfolio concentration rather than some arbitrary and artificial lines of demarcation imposed on an increasingly integrated system.

While my comments this morning have been largely negative, I would like to express my support for the provisions of S.2181 and S.2134 which streamline the federal regulatory approval procedures. These reforms are long overdue. I also endorse the proposal to require the payment of interest on reserves and the recognition of regional interstate banking compacts. I commend the members of the committee for their willingness to address these difficult and controversial issued in a timely fashion. Thank you again for the opportunity to present my views on these vital issues.

SUMMARY OF COMMENTS FROM INVESTMENT BANKERS REEGARDING MINIMUM ASSET SIZE FOR FINANCIAL INSTITUTIONS TO HAVE ACCESS TO THE NATIONAL CAPITAL MARKETS

1. Kidder, Peabody: The firm has a policy of underwriting securities issued only by those banks large enough to receive a single A rating from one of the rating agencies. Generally the minimum asset size is $1 to $2 billion. On occasion they will do a small private placement for a very profitable bank of $750 million to $1 billion. They will contact two or three insurance companies and the offering will essentially be a borrowing. They do CD's only for the sixty largest banks. There is a size criteria of $1 to $2 billion.

2. Goldman, Sachs: The smallest bank they have ever done a deal for had $2 billion in assets. The cut-off would probably be $1.5 billion, but certainly they would not deal with any firm less than $1 billion.

3. Lehman Brothers: The smallest size of regional bank they would deal with would be $1.5 billion.

4. Merrill Lynch: Investors in bank CD's generally require $1 billion in deposits as a minimum for the issuer. About the least is $750 million; "$800 million is tough to sell". Investors never hear of banks smaller than that. The bank may be the largest in a particular area, but investors are reluctant to invest in an unknown company.

   $1 billion is a good cut-off. Investors like bank holding companies to have credit ratings from the credit agencies. Commercial paper would require a larger asset size because there is no implicit government deposit insurance behind it. The smallest Merrill Lynch has done is several billion in assets. Generally the company would have to be even larger to issue subordinated debentures or preferred stock. Early this year Merrill Lynch co-managed a preferred stock offering of a $600 to $700 million asset bank, but this is an exception

FEDERAL RESERVE BANK OF SAN FRANCISCO
SAN FRANCISCO, CALIFORNIA 94120

November 15, 1983

MEMORANDUM TO: HARRY GREEN, Vice President
Supervision, Regulation and Credit

COPY TO: JACK BEEBE, Vice President
Economic Research

FROM: BARBARA BENNETT, Associate Economist x 3153
Economic Research

THOMAS KLITGAARD, Associate Economist x 3530
Economic Research

SUBJECT: STUDY OF REGIONAL BANKS' ACCESS TO CAPITAL MARKETS -- PREPARED FOR UTAH STATE BANKING COMMISSIONER

Our investigation of regional and smaller banks' access to national money and capital markets revealed that, as a rule, banks with less than $1 billion in total deposits simply cannot acquire funds in the national markets. Banks with only a few billion dollars in deposits may be able to do so, but frequently must pay a substantial interest rate premium (up to 50 or 75 basis points). Moreover, on a percentage basis, brokerage fees for these banks represent a substantially higher additional cost since the value of any given placement is much smaller than that of the larger banks' placements. However, a few regional banks in this size category do seem to be able to raise funds in the negotiable CD and commercial paper markets on almost the same cost basis as the money center banks. Investors are apparently willing to purchase their paper with premiums of only 5 to 10 basis points because these banks are perceived to be well-managed and an investment in their paper provides some measure of portfolio diversification. The demand for this paper is limited, however, and these regional banks cannot and do not resort to the national markets to the extent that the large banks do.

It is not clear, however, that relatively limited access (or no access at all) to the national markets necessarily means that smaller banks' marginal cost of funds is higher than that of money center banks. In particular, the creation of the MMDA and the deregulation of rate ceilings on most time deposits have opened up opportunities for smaller banks to raise sufficient funds in their local markets. The only added cost of relying almost exclusively on local sources is the risk inherent in not having diversified funding sources. (Loan participations to correspondents, however, can help to reduce this risk.)

Sources consulted in this study:

Articles

We found several articles which touched on the subject of rate-tiering in the national money markets. Attachments 1, 2 and 3 are photocopies of the relevant sections of those articles. Attachment 1 describes the development of a multi-tier market for negotiable CDs, indicating that large banks generally pay less than smaller banks. Attachments 2 and 3 describe the rate structure of the bankers' acceptance market, where tiering by size of institution is also prevalent.

Data

Another source of information on smaller banks' access to national money market is the weekly report on the assets and liabilities of large commercial banks in the Twelfth District. It is clear from the amount of holding company issued commercial paper outstanding at these large banks that the commercial paper market is simply not open to any but the largest banks. In fact, the five largest banks account for over 90 percent of Twelfth District banks' commercial paper issuance.

Contacts

We contacted one small bank (total deposits of less than $300 million), two medium-sized banks (total deposits between $300 million and $1 billion) and two larger regional banks (total deposits of more than $1 billion). The smallest bank indicated that it did not have access to and did not need access to national money markets. In general, insured deposits could be raised locally in sufficient volumes. Moreover, it could bid for state and local government deposits as needed. These public funds are generally more expensive than "core" deposits, but are not out of line with rates prevailing in the national money markets.

The medium-sized banks indicated that they did have limited access to national sources of funds, particularly through the placement of small denomination notes. However, this source of funds was expensive -- on a $10 million placement in May one of the two banks indicated that it probably paid 50 - 75 basis points more than a money center bank would have paid after taking the brokerage fee and the rate premium into account. Both banks indicated, however, that the recent deregulation of time deposits should enable them to raise funds locally on a par with large banks.

The larger banks both issue commercial paper and negotiable CDs in the national markets from time-to-time. Because they manage their reliance on this source of funds carefully, they do not pay more than a few basis points' premium vis-a-vis the rates paid by money center banks. In general, however, they rely primarily on local sources of funds which, one of the bankers conceded, are probably less expensive on the margin than commercial paper or negotiable CDs.

Barbara Bennett

Thomas Klitgaard

ATTACHMENT #1

ture of CDs. However, the timing of changes in the average maturity of CDs sheds some light on the question. The average maturity of CDs actually declined slightly following the September revision and increased rapidly beginning in early 1975. Since the December revision in fact weakened the incentive banks had to lengthen CD maturities, the abrupt increase in the average maturity in early 1975 seems primarily attributable to the sharp runoff of CDs which began at that time.

Moreover, the actual changes in the spread of the six-month CD rate over the one-month rate were far greater than could have been produced by the modifications to reserve requirements. Simple calculations show that, all other things being equal, the change should have been an increase of 25-30 basis points in the spread of the six-month rate over the one-month rate. However, the spread increased by about 125 basis points from late 1974 to the end of 1975 and then was in large part reversed by the end of 1976 (Chart 3). This roughly followed the pattern of changes in the structure of interest rates in other markets. The actual behavior of the spreads thus suggests that market forces have a determining influence on the structure of interest rates in the CD market, while the influence of the differential reserve requirements is difficult to isolate.

A multitier market emerges

Though the CD market underwent a variety of shocks during the 1973-74 boom, it performed quite well. Unlike earlier booms, when Regulation Q ceilings precipitated a runoff of CDs and a severe thinning of the secondary market, in 1973-74 banks were generally able to market their CDs successfully—though they had to pay quite costly interest rates—and no discernible transactions decline occurred in the secondary market. The principal change was the advent of a "multitier" market, in which the rates paid by banks on CDs were tailored according to investors' perception of the riskiness of the issuing banks.

The collapse of the United States National Bank of San Diego in October 1973, followed by Herstatt in Germany and the Franklin National Bank in New York in 1974, had significant ramifications. For the first time since the 1930's, the specter of possible failure of even major financial institutions arose, making investors more sensitive to relative risk in evaluating CDs issued by different banks. Accordingly, investors did demand noticeably higher rates on the CDs of banks viewed as less stable. Since the early years of the CD market, distinctions had typically existed between rates paid by banks then classified as prime and nonprime, but the multitier market introduced a rather more refined differentiation. For the most part, in the new tier structure, the larger banks pay lower rates.

Bank size affected rates paid on CDs in two ways. Liquidity considerations favored the CDs of the large money market banks, since the secondary market for them is the most developed. And banks that attempted to place issues of their CDs beyond the circle of regular customers who knew them well had to pay a premium. For both reasons, regional banks trying to tap new sources of funds with their CDs in 1974 generally had to pay higher rates than did large money market banks. In 1975, when public attention began to focus on the financial crisis in New York City, even some large New York City banks found their CDs being less favorably received by investors than before. That change in the structure of CD rate tiers has since moderated significantly.

The development of a tiered market in CDs may betoken the maturation of the CD as a money market instrument. The earlier, relatively crude differentiation between prime and nonprime CDs was a rather peculiar feature of the CD market. A refined structure of tiered borrowing rates has, for example, long been a standard feature of the bond and commercial paper markets. In response to the development of tiering in the CD market, some banks may very well have changed their approach to lending or investing funds obtained through CDs, thus giving more emphasis to asset management relative to liability management. It is probably safe to conclude that banks are now far more conscious of the impact of their incremental CD exposure on their total cost of purchased funds than they were prior to 1974.

Another indication of the maturation of the CD market is that, as banks on the whole faced sluggish loan demand from the beginning of 1975 until relatively recently, they allowed their CDs to run down. At the same time, they restructured their balance sheets by expanding their investment portfolios considerably. This is the first time since 1961 that banks in the aggregate voluntarily reduced their CDs to any significant extent; earlier contractions had occurred when market rates exceeded Regulation Q ceilings. At other times CDs were always growing, even when loan demand was sluggish. This altered behavior may mean that the rapid growth stage of CDs has ended. From now on CDs will probably expand and contract in step with the movements of loan demand.

Developments in borrowings of United States banks from their foreign branches were less dramatic during 1973-74 than in 1969. Such borrowings were subject to reserve requirements during 1973-74 and, since Eurodollar rates typically exceeded CD rates, Eurodollars were generally a more expensive source of funds for United States banks than were CDs. Equally

William C. Melton, " The Market for Large
Negotiable CDs."

ATTACHMENT #2

ondary market are an important consideration in acceptance creation and regulation. Until 1973 member banks' funds derived from the sale of eligible as well as ineligible acceptances were free from reserve requirements. In mid-1973 the Federal Reserve Board ruled that member banks who derived funds from ineligible acceptances—those that did not meet Section 13(7) conditions—had reserve requirements on those funds.[9]

The Monetary Control Act of 1980 brought nonmember institutions under the reserve requirement authority of the Federal Reserve.[10] Regulations to implement this act also extended reserve-free treatment to funds derived from the sale of acceptances in the secondary market by these institutions. To qualify as nonreservable funds the underlying acceptances (technically eligible for purchase) were to be "of the type" specified in Section 13(7) of the Federal Reserve Act.

These rules have blurred the distinctions between acceptance eligibility for discount and for purchase. Member bank officials indicate that most acceptances created by these banks are eligible for discount. The secondary market applies a lower discount (i.e., interest rate) to acceptances that are eligible for discount and to all eligible acceptances from prime banks.

To the limited extent that nonmember depository institutions create acceptances, their instruments tend to meet the conditions of Section 13(7). Therefore, the funds obtained through rediscount in the secondary market are treated as nonreservable.

Most institutions avoid creating ineligible acceptances, because such instruments are not well received in the secondary market. In addition, reserve requirements apply when these acceptances are rediscounted in the secondary market. To the extent ineligible acceptances arise, they are usually held in the account of the bank that created them.

The secondary market

Banks place acceptances in the secondary market through two channels—direct placements and a network of dealers who "make a market" in the instruments.

The direct sale of acceptances in-house by banks' newly established money-market and investment departments has helped these banks to satisfy customer demand for short-term investments with relatively high yields. Such direct sales allow banks to avoid the added costs of selling through acceptance dealers—still the primary outlet for acceptances.

Bankers' acceptances are sold in the secondary market by a small group of money-market dealers who act as intermediaries between banks and investors. The dealer network is centered in New York City, where about 50 percent of the dollar volume of all acceptances is created. The Open Market Desk of the Federal Reserve Bank of New York is the center of Federal Reserve acceptance activity.

The dealer market has five tiers. The first tier consists of the ten largest acceptance creating domestic banks. Because acceptances of the top-tier banks are generally viewed as the safest and most marketable, these instruments command the lowest rates (i.e., discounts) in the dealer market. Second-tier banks are the next-to-largest U.S. banks in terms of acceptance creation. By virtue of their reputation among dealers and investors, second-tier acceptances usually trade at rates very close to rates for the first tier. Third- and fourth-tier institutions are those remaining U.S. banks that are somewhat active in the dealer acceptance market. Secondary market rates on lower tier acceptances vary considerably across these instruments, but are substantially higher than rates for the top two tiers.

The fifth tier of banks consists of foreign-owned institutions. A subcategory within this tier includes acceptances originated by U.S. branches of Japanese banks. These "Yankee BAs" and others in the fifth tier trade at considerably higher rates than acceptances of comparable U.S.

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[9] In the early 1970s funds derived from the sale of ineligible acceptances were not subject to reserve requirements. A number of banks used this fact to advantage during periods of tight credit by creating a substantial volume of finance bills, or working capital acceptances (ineligible), and placing them in the secondary market. The Board of Governors imposed reserve requirements in mid-1973 on bank funds acquired through such instruments, sharply curtailing banks' activity in ineligibles.

[10] Prior to the Monetary Control Act of 1980, reserve requirements on nonmember bank funds acquired from the sale of ineligible bankers' acceptances in the secondary market were set by state banking laws.

Jack L. Hervey, "Bankers' Acceptances Revisited," FRB Chicago Economic Perspectives, May/June 1983.

ATTACHMENT #3

Box 1: Federal Reserve Participation in the Acceptance Market during the 1970s *(continued)*

Finally, during 1974, two other important changes were made in the System's acceptance operations to make them conform more closely to market practices. In July, the requirement of dealer endorsement of acceptances sold to the System and customer accounts was terminated. In earlier years such endorsement had been a common practice, but by the 1970s the System was the only market participant requiring it.

The second change, effective in November 1974, was the termination of the Federal Reserve guarantee provided for acceptances purchased by the Desk on behalf of the accounts of foreign central banks. This procedure had probably performed a useful role in promoting the development of the acceptance market in earlier years, but by the 1970s it was creating difficulties. In April and May 1974, acceptance rates rose rapidly relative to rates on Treasury bills. During the May-September period, the gross spread exceeded 200 basis points and peaked at over 400 basis points in July, compared with a more normal spread of less than 100 basis points.[3] In these circumstances, foreign central banks regarded investments in Federal Reserve-guaranteed acceptances as especially attractive. As a result, acceptances held in foreign accounts mushroomed from $581 million at the beginning of the year to over $2 billion (11.8 percent of total acceptances outstanding) shortly before the termination of the guarantee in November. In the view of the Board of Governors, the guarantee of a particular money market instrument for the benefit of a particular group of investors was unwarranted. Following its termination, the number of active foreign accounts declined from twenty-five to six, and the dollar amount held in these accounts fell to $293 million by the end of 1975.

[3] The net spread was slightly less, since the Federal Reserve charged 1/8 percentage point for its guarantee and passed on a 1/16 percentage point charge for the dealer endorsement. However, with the termination of dealer endorsements in July, this latter charge was removed.

Box 2: Structure of Acceptance Rates

During the 1970s, the trend toward negotiated dealer rates and the emergence of a tiered rate structure greatly affected the workings of the secondary market. The more refined rate tiers reflected greater discrimination among different bank names by investors.[1]

Prior to 1969, acceptance dealers posted the rates at which they would sell prime acceptances. Rates on acceptances perceived as more risky were scaled off these posted rates. In late 1969, two firms announced that they would no longer follow this practice but would negotiate rates on a case-by-case basis. Their motive was to increase their share of the market. Although negotiation away from posted rates had occurred from time to time prior to 1969—largely as a *sub rosa* practice—negotiated rates were the exception rather than the rule. Other acceptance dealers continued to post rates after 1969 but reserved the right to negotiate. At the same time, though, these dealers began to display greater flexibility in changing their posted rates.

In 1974, following the emergence of problems at Franklin National Bank, prime acceptances were no longer considered to be a homogeneous group, and thus posted rates became less meaningful. Most dealers opted instead to quote a range of rates within which they expected to trade prime acceptances. This reflected a greater tiering of acceptance rates, similar to the tiering which developed simultaneously in the CD market.[2] The final abandonment of posted rates occurred in August 1974. Accordingly, the Federal Reserve then began collecting data on the range of rates quoted by dealers on prime acceptances.

Practices affecting secondary market acceptance rates have not changed materially since 1974. Dealer firms continue to quote ranges of rates (about 10 to 15 basis points) within which they expect to trade prime acceptances. The rates tend to be inversely related to the size of the accepting bank. As a rule, acceptances from the top ten or so money-center banks trade at rates at the lower end of the dealers' quoted ranges, and acceptances of well-known regional banks and United States agencies and branches of foreign banks trade at rates near the top of the ranges. Acceptances created by smaller and less well-known banks trade at considerably higher rates.

[1] Although an acceptance is also the contingent liability of the drawer of the draft, the market has long since come to rely on the credit quality of the accepting bank as the primary criterion of the credit quality of the acceptance.

[2] The emergence of rate tiers in the CD market is analyzed in Dwight B. Crane, "Lessons from the 1974 CD Market", *Harvard Business Review* (November-December 1975), pages 73-79.

William C. Melton and Jean M. Mahr, "Bankers' Acceptances."

The CHAIRMAN. I apologize for the briefness of time. Although you have been in Washington and we are not applying any different rules than we do in the hearings back there, we do have even more witnesses this afternoon than we normally schedule beause I wanted to give everybody an opportunity that wished to testify to do so.

I agree with your analysis of the separate bank holding companies and I think you know that. We have had enough discussions, but we have been in a small minority.

My original S. 1720 started out in 1981 the way you suggested it should be set up and finally it was put into a bank holding company and that whole section was deleted. And simply, to be blunt about it, if there's one thing you learn in the Senate it's how to count. And I couldn't count very many votes that agreed with you and I. I still believe, even though I have been beaten down on that proposal, but I still believe you and I will see if we can talk them out of the holding company because it has an adverse impact on the smaller companies.

Before I continue I might——

Senator LAUTENBERG. I have a procedural question. Are we going to have any time for question and answer?

The CHAIRMAN. Yes; with each panel we will go through the panel and then we will be able to ask questions of all panelists.

I did want to mention, and not forget, which I did when I mentioned his position, but Mr. Day is immediate past president of the National Association of Insurance Commissioners and I think that's not only an honor for you but for our State. I'm happy to have you here to testify.

Mr. DAY. Thank you very much. One of the disadvantages is that we don't have those warning lights to signal.

The CHAIRMAN. No; I did away with that.

Senator LAUTENBERG. With Chairman Garn, you know when your time is up.

The CHAIRMAN. I thought those lights were offensive. Now we send you notes.

Mr. DAY. A much more humane system.

The CHAIRMAN. Let me say before you go on that your entire statements will be printed in the record and any supplements or detailed information you want to supply the committee will be placed in the record.

Mr. DAY. Thank you.

[Complete prepared statement follows:]

PREPARED STATEMENT OF ROGER C. DAY, COMMISSIONER OF INSURANCE, STATE OF UTAH

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ROGER C. DAY
Commissioner of Insurance

I am Roger C. Day, Utah Commissioner of Insurance. I appreciate the opportunity to testify. My remarks will not attempt to systematically discuss the specific provisions of these Acts. I hope, nonetheless, they will be of topical relevance. Although my basic concerns appear appropriate to both measures, they are addressed more precisely to the issues pertaining to S. 2181 since S. 2134 appears far less expansive in the insurance underwriting field and more modest in its possible effect on current regulatory systems.

I congratulate the Chairman and members of the Committee for providing a forum for reregulatory consideration of the financial services marketplace, which is something more than simple deregulation. Even though I am not persuaded that such a definitive and, from my perspective, massive overhauling of financial intermediary powers, limits, and regulatory oversight has been shown to be necessary, I recognize the contribution that such proposals may make.

There are provisions in S. 2181 which are improvements over S. 1609. Specifically, the section requiring that a state amendment to the powers of a state chartered depository institution to allow the sale or underwriting of insurance must apply within the state of domicile if it is to apply in other states is at least superficially gratifying in light of recent developments. I am not, however, as concerned about the likelihood of wholesale, irresponsible deregulatory competition at the state level as are others. In fact, the diversity and experimentation possible within the state laboratory well serves the nation and obviates against the necessity of more massive experimentation as exemplified by this measure.

The provisions of Section 1007, though not yet providing sufficient protection against implicit or explicit credit coercion in the sale of insurance, are a step in the right direction and underscore the adverse impact such coercive potential has on the maintenance of a fair market that operates to serve the best interests of consumers rather than the best interests of those who control access to consumers. A more complete standard could be developed using penetration rates of controlled or affiliated retail accounts as a foundation and providing graduated disclosure standards and other limits if such activity is not to be contrary to the public interest. It seems surprising, at the least, that no mention of state authority occurs here to use the decentralized resources already in place and to assure that the current system is not pre-empted in its ability to regulate unfair sales or trade practices.

Although Section 1008, along with other sections, provides for a report to Congress concerning the effect of passage, no insurance or other state regulators are to be involved in preparing any reports nor does any report required mention specifically the impact of these amendments on the private insurance mechanism or the cost or reliability of insurance as it may be affected by their passage. This strikes me as an obvious, easily corrected oversight .

In general terms, though a principle intent was to provide a departure point for subsequent consideration, S 2181 undertakes too much, too quickly. I would be more assured that no impairment of the current insurance regulatory mechanism occurred if an explicit section so provided and reaffirmed the applicability of state insurance laws including Insurance Holding Company Acts, and if regulators were specifically authorized to provide and share information with each other as part of their official duties where joint jurisdiction, such as the insurance activities of depository institutions, occurs.

Achieving the intent of the Act to allow greater marketplace freedom in the organization and distribution of financial services does not require its passage. Innovation in financial services has been occurring for many years and substantial authority to innovate and compete is already available among and between financial service intermediaries.

It has been noted that government tends not to provide leadership in economic and social developments; it follows the marketplace which is most often the engine of creative change with regard to such developments.

The concern about equal, competitive viability or the creation of a level playing field is not a topic resoluble within my allotted time except to assure you and all interested parties that I regard state insurance regulation as constituting a level playing field, particularly to the extent that it retains its jurisdiction and efficacy rather than being subject to federal preemption or potentially inadequate or conflicting jurisdiction. In a report prepared for several banking institutions, Stewart Economics, Inc. noted, "If general public policy so determines, insurers and banks (which are subject to regulatory systems with similar goals, methods and procedures) can be brought under common corporate control, without overtaxing insurance regulation. State regulation of insurance should be able to deal with insurer-bank affiliation just as well as it has dealt with other affiliations in the past."

I think the incentives to create integrated products or integrated financial service delivery systems are well known and documented. They include, most importantly, new technological capability; the decision not to create regulatory limits, such as reserve requirements or other standards for money market funds, the subsequent financial deregulation of competing entities through removal of the interest limits paid by depository institutions and certain actuarial limits on insurance products;

the effect of sustained high or volatile interest rates on all financial intermediaries on their portfolios as well as on the condition and apparent demand in their markets, and demographic and other consumer based changes. Such pressures have caused changes within as well as between intermediaries and insurance regulation has responded. In fact, all of the existing integrated financial service giants are already well adjusted to insurance regulation and dynamic insurance regulation is continually improving its ability to protect the public interest in light of such changes.

The record of state insurance regulation has been to accommodate and encourage, where appropriate, the development of innovation and competition, including interstate competition, between and among insurance entities. As a matter of public policy, I favor constructive competition in the delivery and underwriting of insurance provided that markets remain fair and beneficial to consumers. I, therefore, have no fundamental opposition to insurance practices, per se, being conducted by depository institutions. Utah is one of thirty-one states which does not provide a specific prohibition against such participation. Consequently, a number of institutions are involved in insurance sales including federally chartered institutions which are covered under grandfathering provisions. I hope it is appreciated that I have no desire to maintain any special preserves for insurance operations. Outside of specialized products or marketing niches, it is not likely, however, that any markets could become more competitive in insurance.

Two specific issues are raised, somewhat more acutely, however, by the size, nature, complexity, and regulatory oversight of such institutions that do not exist to the same extent for other enterprises. These include the coercion issue and holding company monitoring and appropriate access which is a serious issue in insurance regulation already. I am not extremely comfortable with the addition to insurance markets of a substantial number of large and complex holding structures unless improved holding company controls exist. I will go into more detail on this point later if the Committee wishes since it involves fairly narrow, technical issues necessary only to make sure that such structures are not used to circumvent the principal intent of insurance regulation.

Certain pre-conditions to effective insurance regulation must be preserved if the state regulatory system is to continue to function effectively to protect the public interest as contemplated by the Congress in its organic grant of authority to the states in the McCarran-Ferguson Act. Most of these conditions are similarly pre-conditions for the maintenance of integrity for the specific functions of other regulated financial functions as well. They include: 1) No federal preemption explicitly or implicitly of state authority, especially to regulate insurance, and identical rules for all insurance participants; 2) The use of separate corporations for insurance underwriting activity to allow an insulation of assets supporting insurance operations from those which support other operations; 3) The use of multiple, state issued licenses for insurance activity for insurance underwriting and for sales; 4) Continued jurisdiction under the Insurance Holding Company Act for Holding Company Act transactions, including the right to hold parent corporations responsible for a reasonable period of time on a reasonable basis to cure adverse consequences arising out of affiliate transactions and supervision of dividend or other affiliate transaction authority; and 5) Continued effective authority at the state level to limit any use of credit or debt coercion or other unfair trade practices.

I have no more and no less concern about the solvency potential or business integrity of leading banking concerns and their managements as compared to insurance managements or other financial intermediaries. My concern is that the insurance business, because of the nature of its products and their value to purchasers and claimants, must be operated on the basis of the highest fiduciary obligation and that any practice or activity which threatens performance upon this obligation should not be permitted by an insurance holding company or a bank holding company or any other structure.

Any act finally passed should distinguish between and treat separately the risk and implications of underwriting activity, since the solvency of the principal underwriting structure is of paramount regulatory concern whether its purpose is to provide loans, securities, or insurance coverage, and the risk and implication of sales activity. The issues raised by the sale, distribution, or other related services affecting insurance which could be undertaken under the act generally already exist in the financial services marketplace in some fashion and could be addressed more appropriately independent of the underwriting question.

S. 1609 appeared to be overly concerned with creating additional profit centers to improve the financial condition of banks. It would be a vast improvement if any final measure did not suffer from a similar pre-occupation since the financial condition and problems of other financial intermediaries are very similar and encouraging integration of financial services at an accelerated rate for such a purpose may well not serve the public or indeed provide the hoped for benefit to the banks themselves.

The use of separate specialized corporations for discrete activities may not, by itself, provide sufficient insulation or separation to protect secured and innocent parties from harm. Alternatively, the concentration of radically different forms of risk could have a destablizing effect rather than achieving the intent of the authors. Though there is an ostensible limit on the ability of holding companies to engage in improper affiliate transactions and an effort is made to insulate the separate financial service entities, the possibility of adverse consequences from intensifying liquidity risk within the overall system or subjecting the whole to a combination of risks which are subject to similar economic cycles, such as credit risk and insurance underwriting risk, may not support the contention that radical restructuring on this scale is necessary, justified, or helpful.

If it is concluded, as a matter of legislative policy, that banks or others currently suffer competitive disadvantages compared to other financial intermediaries with whom they must compete for funds, then a more direct and simple approach might be to amplify by statute in a fashion much less dramatic than that contained here those activities found and administered as being "closely related to banking." This would put at far less risk the integrity and efficacy of current function based regulatory systems and retain dispersed regulatory authority which has served the public well.

In addition to the argument pertaining to the dangers of specific concentration of economic power, which I recognize has been subject to partial amendatory limitation in this measure as compared to S. 1609, an equally important issue is the desirability of maintaining a dispersion of regulatory responsibility and options among different regulatory systems specifically designed to assure the integrity and reliability of the functions of differing financial services. This dispersion may be implicitly if not actually compromised under this Act.

Market innovation develops without the necessity of government intervention. There is no doubt that within most if not all regulatory structures at both the federal and state level a substantive reregulatory process has been undertaken to better refine techniques, objectives, and procedures. It may be prudent and desirable to allow this reformation and revitalization process to have more time to accommodate to a changing marketplace rather than attempting to accelerate the process by legislative fiat.

A slower and more incremental strategy certainly implies less risk, less adverse consequence of error, and allows more opportunity for fine tuning. It does not seem consistent with either the decentralized or "new Federalism" trends of society or reliance on the marketplace to create a centralized policy expectation as contemplated by this act before existing financial managements have fully used current opportunities to answer, through marketplace innovation and testing, the feasibility and benefit issues without this massive a restructuring.

Security and protection mechanisms, including deposit insurance and guaranty fund coverage of insurance operations, should also be an element of concern in the reregulatory process. Careful thought and structure limiting the applicability of security mechanisms should occur so that no unintended or unwarranted protection is established where the nature of the funds or transactions involved have the form or effect of investment or speculation which would go beyond the valid initial purposes of the security mechanisms, affect competitive parity, and possibly affect the ability of the security mechanisms to meet their principle objectives.

Given the financial deregulation which has already occurred and the increasingly competitive financial services marketplace such a review is indicated in any case but made imperative by the integration possible under these acts. Similarly, the funds used for ancillary activities should not place at risk the policyholders or claimants of insurance companies nor the depositors of financial institutions. Specific coordination of regulatory standards and treatment to assure that preferred status claimants, such as insurance policyholders or claimants or financial institution depositors, are indeed treated preferentially and are not put in conflict in the event of insolvency should also occur whether this Act passes. Such a position is absolutely essential to the sound and impartial administration of this Act should it pass. This may require an amendment to the Federal Bankruptcy Act.

I think it bears constant reiteration that the fiduciary nature of the products provided by financial intermediaries such as banks and insurers qualitatively differ from those provided in general commerce. Increased competitiveness in the financial services marketplace does not and should not mean that historic concerns with safety, soundness, and reliability should be lessened.

Likewise, the specialized nature of products and services and the necessity of consumer trust and confidence in those distributing them will remain a universal prerequisite to market success. The specialized training and management required to achieve and perform on such trust may substantially reduce the supposed consumer benefit of "convenience" thought to exist in integrated delivery structures. It is extremely difficult to adequately train and manage competent single sources for distributing such specialized products or maintain a delivery system sensitive to consumer needs and potential consumer jeopardy across widely differing lines of product and activity.

Liquidity stresses, thinner margins, expensive distribution systems, and other common problems tend to characterize all financial service institutions. A need to become more efficient without losing personal competence or accessibility is also universal. It seems doubtful that there will or should be a single strategy of success in responding to these challenges and equally unlikely that a single method of doing business will be appropriate for all of the markets requiring specialized service.

Given these common problems and existing innovation to resolve them, patience and caution in reform, which is not served by an act of Congress of this magnitude and uncertain effect, may be more appropriate than building a new playing field in the hope that it will be more level or have better referees, coaches, or quarterbacks.

Thank you.

The CHAIRMAN. Senator Gorton has an airplane to catch and has to leave in about 15 minutes so I'll turn to him first for his questions.

Senator GORTON. Ms. Weis, I was intrigued at your testimony, the thrust of which seemed to be a series of criticisms of the separate subsidiaries of holding company pattern which has been included in most, if not all, of the legislation which has been proposed so far. If I understood the thrust of your testimony, it was in effect that it had not dealt with the interests of either the depositor of the bank or, for that matter, the customers of those subsidiaries. You can correct me if that's a misapprehension. I'm not sure that I heard quite so much about the impact of what is presumably the only alternative, and that is allowing the operating entities of financial institutions to engage in such businesses as we deem appropriate.

I'm not sure that I got your views on the increased possibilities of tie-in arrangements of the misuse of economic power across varying kinds of activities which have traditionally been independent. I wonder if you would comment on that.

CROSS SELLING

Ms. WEIS. I think this is certainly a consideration, as Roger has said. I don't know that if it's in a holding company affiliate that there would be any less of an incentive or if that would really create a barrier to cross selling. Also, that's the other side of it.

One of the benefits of being able to offer a full range of services is to cross sell. The question is: Where does cross selling cross the line into coercion and where do you draw it?

Senator GORTON. Do you feel that the present antitrust laws are sufficient to protect against a misuse of that concentration?

Ms. WEIS. Roger is shaking his head because credit life insurance is a prime example that Roger has been involved in. I don't know. I think that there needs to be—it's going to be difficult not to cross sell because that's one of the benefits and that's what we are encouraging. But I think there should be very clear disclosure that this is an affiliate company and no requirement that any borrower, or consumer, or businessmen be required to obtain the service that is offered.

I think from the users' standpoint, psychologically you can approach it the same way. If I do more of my business with this institution, I will get a better deal. Just as on the other side if you buy all the services, I'll give you a better deal. But I think that's really the way business is conducted.

Senator GORTON. I think Mr. Day wants to comment on that and I'd be happy to hear some of it.

Mr. DAY. It's been my perception that the antitrust laws do not supply an administratively feasible way of supplying such standards and enforceable at the State level. It is more likely to have an effect in the more totally but difficult to obtain area that would arise in the antitrust laws.

For example, I believe in something to the penetration rates of an affiliated transaction that could be administered simply and would presume as you penetrate them you tell the accounts board that you had a higher burden for disclosure or were subject to other limits would be more feasible. When and if it is decided.

The **Chairman**. May I say, Senator, how much I appreciated you taking the time to come by for the hearing even though you have to leave a little early to get home.

[Whereupon, Senator Gorton left the proceedings.]

The **Chairman**. Commissioner Weis, we have a fair amount of interstate banking in Utah through affiliations which have primarily come about through the grandfather clauses and grandfather provisions under the Bank Holding Company Act. What effect do you feel that this has had on Utah banking, purely domestic institutions? An adverse impact or a positive benefit of those affiliations?

Ms. **Weis**. Well, as a capital importing State my opinion would be that it has probably been very beneficial in that it has provided capital resources outside of the State that generally has been imported into the State, not where deposits from the State have been exported elsewhere.

We have a number of companies that have their primary operations in other States or that operate significant divisions in other States that were either grandfathered or under our savings and loan reciprocity division or savings and loan corporations, a number of whom are owned by large institutions. We have not really had a negative experience with the amount of interstate transactions or ownership we have had in the State.

Senator **Lautenberg**. You have statewide banking?

Ms. **Weis**. Yes; we do.

The **Chairman**. We are not like Illinois or New Jersey where you can't cross county lines.

Senator **Lautenberg**. In New Jersey we had county and then regional and then statewide.

Mr. **Chairman**. Let me ask you a couple questions. If you feel there have been positive benefits, does that lead me to conclude that Utah should be more open than some other banks we are talking about?

Ms. **Weis**. There's a great deal of discussion. There's a distinction between our banking law and savings and loan law. Savings and loan we do have reciprocity and in the banking statute we do not. There is some discussion going on at this point about working on contacting the surrounding States on an interstate regional compact for the States in this region, primarily Colorado and Idaho. There are mixed feelings in the industries about whether they want to pursue that at this point.

The **Chairman**. Commissioner Day, the legislation also included insurance activities for bank holding companies. You urge in your testimony that adequate authority be given to State oversight of such holding companies, that aside from engaging in those type of activities. What are your general needs as a State insurance commissioner? What would your office need to do that?

RETAIN STATE JURISDICTION TO REGULATE HOLDING COMPANIES

Mr. **Day**. To retain our jurisdiction as compared to others, the primary regulatory responsibility to regulate holding companies. I'm not sure even the holding companies themselves or the other regulators involved would be happy to have that shared jurisdiction.

Our insurance to date with holding company instructors in the insurance field suggests that there needs to be more close monitoring of dividends of the holding company to make whole its subsidiary for affiliate transactions. New York State has provisions similar to that and has not, as a consequence, experienced the same degree of problems jeopardizing the policy welfare as other States have.

I do not believe those will be insurmountable or present any difficulty in shared jurisdiction. But I think they would be a prerequisite to policyholders in the event of more holding company activity.

The CHAIRMAN. How do you regulate insurance companies today?

Mr. DAY. They first have to receive permission and sign statements on affiliate transactions. One is tempted to say in most States inadequately, in answer to your question. Basically by monitoring the interaffiliate transactions is the mechanical method. The responsibility of the holding company who makes whole its subsidiaries if they have created any impairment there, I think, would change the incentives. It would be an issue to this measure if we are to provide for extensions.

And the specific issues of concern are that you can use a holding company structure to create a parent surplus for the entity in the chain that does not exist within each of those incrementally. You create conflicting interest between shareholder interest and policyholder interests and you end up with claims against the holding structure being essentially unsecured.

Since most holding companies believe it is necessary, from a business standpoint, to not be regulated in the first place, they take a dim view of having shareholder interest subordinated to policyholder interest. But for policyholder security and, even more importantly, claims against those policyholders, such a structure I think would be necessary. I don't think that's inconsistent with interstate competition involved in insurance sale. It is just to recognize there are different orders that have to be secured.

The CHAIRMAN. Thank you.

Senator Lautenberg.

Senator LAUTENBERG. Ms. Weis, I was interested in your general perspective because we have some very specifically shared views. I think I heard you say that the regulation is fine as long as it doesn't encroach on the system that exists within the State and you talked about small banks, $20 million, $10 million banks was your point of reference.

In New Jersey State, the most densely populated State in the Union, of which we are proud, for the benefit of my chairman, we have a lot of small banks in the State and have had. There are fewer and fewer all the time. They continue to merge. I don't know what regulation you have prohibiting that within the State, if any. But a concern of mine is that the services that small banks provide to the community will not exist if we continue on the roads toward nationwide banking, though the chairman here has expressed his opposition to it or at least preferring some regional——

The CHAIRMAN. Let me say that I think dual banking exists and I will continue to do everything I can to preserve that dual banking system.

Senator LAUTENBERG. Since you are not in the witness chair, I thought I paraphrased you about national banking institutions. Do you see that as a concern? What's the largest bank in Utah?

Ms. WEIS. The largest bank is a little over $2 billion.

Senator LAUTENBERG. And that, in the definition of the big guys, is a small bank. Even in Jersey it's an $11 billion bank even after merging the largest two.

The CHAIRMAN. It's No. 99.

Senator LAUTENBERG. But you should see the dropoff from No. 25 down to No. 100.

Does it adequately service the capital needs of a State like yours? There's a lot of development and a lot of interest in natural resources. Would you be concerned, let me put it this way, if there were nationwide banking that Utah might not have that special character bank that you talked about?

Ms. WEIS. I doubt any nationwide banks would be interested in acquiring a bank in a small town in Utah. I think the targeted banks would be the larger banks and that could be detrimental because those are the institutions that service the larger businesses.

DIVERSION OF RESOURCES FROM THE UTAH ECONOMY

The concern I would have is really that the smaller banks would feel compelled to change their business or merge together or to be acquired. With the type of population concentration we have, urban area with 90 percent of the population in the larger banks in that area, the feeling in the rural communities toward the urban banks is about the same as toward the out of State banks.

We would be concerned with the diversion of resources from the Utah economy because loan officers or loan committees located in Chicago, or San Francisco, or New York are going to tend to divert funds into other types of lending with which they are more familiar than with the economy and the prospects in this State.

Senator LAUTENBERG. So to make sure I don't misunderstand, you would be concerned, to say the least, about nationwide banking outside of the State?

Ms. WEIS. I think the large local banks would be the targets and that would divert resources.

Senator LAUTENBERG. I think you make it clear but I wanted to be certain about that because I have some misgivings about that again because I think we are going to leave the community out. Whether it's the small rural community or otherwise, I think you'll see that we will be able to substitute instead of brick and mortar, as was referenced this morning, we will be able to substitute ATM's for maybe a bank someplace. If the folks in the rural areas like talking to machines out there, it will be all right. But if they want to see a face in front of them, it is going to change the banking relationship substantially.

You are also concerned, and I respect your views although I have to classify them as relatively parochial. Not narrow, but parochial. But you were concerned about the area you serve as commissioner of the banking system here in the State. You talked about cross selling, the ability to cross sell. I would have to tell you an observation. When you get a bank that's $10 or $20 million in size, that is very hard to find the management skill and sophistication to offer lots of products. I think it would be at the expense, very frankly, of the basic functions of the regional or community banks served.

I, for one, coming from the business community, am not terribly excited about extending more and more power to banks that, in effect, in the final analysis may cause them to lose contact with the community which is my view of the services.

The cross selling thing, I would submit to you, can be converted from one of opportunity to one of tie-in. That's a major concern of mine. The chairman knows that. It is very hard to separate out what is a tie-in sale when the insignia of one of the most important banks in the country is back over the head of the person who is selling it, whether it's insurance, or real estate, or brokerage, or development. It's an area of great concern.

While I appreciate your testimony, I do think that your desire to keep it free and easy within your State is going to be, at times, in conflict with some of the legislation despite the chairman's admonition to the contrary.

Mr. Day, you being an insurance commissioner, the State of New Jersey has a very well-known insurance company or two. Prudential Insurance Co. is the largest insurance company in the world, as you know. I make a very careful observation. They don't need any regulation. Everything is perfect, of course.

But the fact is that if we get further into the holding company relationship, would it be likely that State insurance commissioners might have the authority to regulate the bank holding company that is either a subsidiary of an insurance company or vice versa?

Mr. **Day**. I think it written and contemplated that there would be some shared jurisdiction under S. 2181 and I think there should be such a relationship if it becomes necessary to assure appropriate regulation on an insurance transaction. That's been our experience of a holding company structure that is used now for interstate competition in insurance.

Senator **Lautenberg**. You get overlapping jurisdiction which everbody is concerned about, including the Vice President and his studies.

Mr. **Day**. I'm not as concerned about shared jurisdiction as with the inability to get shared information which has more often been the problem in keeping the present systems working successfully with one another. That would particularly be true in the principal legislation of the holding company structure, and I am not that person for insurance. That doesn't shut me off in the information I would need to have.

In Prudential's case only to mention the rest, has not caused me not to have any information that is pertinent to Prudential. So I believe it is not burdensome, but it is necessary to make sure that the underlying relationships are conducted appropriately.

Senator **Lautenberg**. You come out, if I can appropriately consume your full statement in a short period of time, on the side of more care and more caution and perhaps more regulation.

Mr. **Day**. I'm a patient incrementalist.

Senator LAUTENBERG. Well said.

Thanks, Mr. Chairman.

The CHAIRMAN. Thank you for your testimony.

I would say as you are leaving, I want to thank Senator Lautenberg so he doesn't misunderstand. We are willing to let you buy things in Utah but we don't want to buy anything from Jersey. We can take over some of their banks but you have to leave ours alone.

May I invite the next panel up: A. Lawrence Higgins, president, Continental Bank & Trust Co., president, Utah Bankers Association; Gerald "Jerry" R. Christensen, president and chairman, First Federal Savings & Loan Association, Salt Lake City; member, legislative committee, Utah League of Insured Savings Associations; R. Blair Hawkes, chairman, legislative committee, Western Independent Bankers, principal witness; and Robert Mobley, member, legislative committee, accompanied by Jon C. Bednerik, executive director; Donald Bleazard, president, Utah Credit Union League; Robert Beckstead, chairman of the board, Utah Consumer Finance Association; chairman of the board, Industrial Loan Guaranty Corp. of Utah; president, Copper State Thrift, accompanied by Richard Van Winkle, president, Lockhart Co.

Mr. BECKSTEAD. Mr. Van Winkle is not here this afternoon.

The CHAIRMAN. I was looking to see if Dick was here but I don't see him.

I would say again I apologize for the briefness of time but we have 13 or 14 more witnesses so if we could encourage you each, at 10 minutes apiece and the few questions we are going to be here quite a while this afternoon which the Senator and I are perfectly willing to do. But I want to assure you your full statements will be in the record. Not only that but we can expect as this process goes on you will continually see information and refinement of your testimony as we get in the hearing process in more detail over the next few months.

Mr. Higgins, if you'd like to begin.

STATEMENT OF A. LAWRENCE HIGGINS, PRESIDENT, UTAH BANKERS ASSOCIATION

Mr. HIGGINS. My name is Lawrence Higgins. I am president of Continental Bank and Trust Co., an approximately $300 million commercial bank located here in Salt Lake City. I am also president of the Utah Bankers Association. All full service national and State-chartered banks in Utah are members of the Utah Bankers Association. The membership ranges in size from over $2 billion in deposits on down. It is the Utah Bankers Association whom I represent today. We wish to thank you for this opportunity to appear.

We do not intend, nor could we in the time allotted, possibly comment on all of the proposals contained in Senator Garn's bill. However, as presidnet of our association, I would like to convey to you some opinions and concerns of Utah bankers pertaining to a few of these proposals. I can assure you that with very few exceptions, if any, the Utah bankers support the general thrust of the bill in the direction of new powers and services for commercial banks and greater competitive equity for all participants in the financial services industry. We are very much aware that what comes out of this committee, and eventually becomes law, probably will determine the way that we bankers do business for years to come; perhaps, much like the banking legislation of the 1930's has done to this day.

NONREGULATED FINANCIAL INSTITUTIONS SQUEEZING THROUGH LOOPHOLES

For some time now, nonregulated financial institutions have entered our markets and offered our customers a wide spectrum of financial services, many of which have traditionally been offered only by commercial banks. They have done so by squeezing through loopholes in present laws and regulations that were put in place to insure the safety and soundness of the Nation's banking system. Traditionally, safety and soundness has been the hallmark of the banking industry and of primary concern to its regulators, and it should remain so. It should be uppermost in the minds of members of this committee in considering S. 2181 or any other banking legislation for that matter.

Certainly the safety and soundness of the Nation's financial institutions is in the public's interest. Therefore, in our opinion you should take the necessary steps to close these loopholes to insure that any financial institution offereing traditional bank services through such mediums as nonbank banks should meet the same criteria for safety and soundness as that prescribed for commercial banks.

We do not shrink from competition. We have proven in the past that we can aggressively compete when free to do so. A good example of this is the results when we were finally allowed to enter the money market funds competition.

Our franchise has been dangerously eroded by nonbank competition that is not subject to the same criteria for safety and soundness placed on banking. This nonbank competition operates outside of the regulatory constraints imposed upon our industry.

In addition, it is frustrating for us to see our traditionally closely related competitors, such as savings and loans, the thrifts and credit unions be given bank-like products and services, while the environment in which they operate is considerably less restrictive than for banks. For instance, savings and loans, which under Garn-St Germain received additional bank-like powers, have less stringent capital requirements and enjoy a Federal regulator in the form of the Federal Home Loan Bank Board who is an advocate for their industry. Our regulator, the Federal Deposit Insurance Corporation, and in some cases, the Federal Reserve Board and Comptroller of Currency take an adversary position to banking.

Recently one of the major thrifts, Citicorp's Person-to-Person, with several outlets here in Utah, was granted the privilege to offer FDIC insurance. This was announced in an article that ran in the Salt Lake Tribune, Saturday, January 7, this year. The article indicates that to date Person-to-Person has $53 million in deposits and six offices in Utah. We have attached this article as exhibit A.

Person-to-Person is a subsidiary of Citicorp, the largest bank holding company in the Nation, and is the parent company of Citibank, the second largest commercial bank in the country. Even though Citibank is prohibited by law from operating in the State of Utah, its parent company Citicorp entered the Utah market through its subsidiary.

Credit Unions once filled a void in the economy by providing an opportunity for individuals with a common field of membership to band together in a not-for-profit environment to afford them a convenient method for pooling savings and making loans for the benefit of their membership. Credit Unions, from their inception, have enjoyed special privileges through their nonprofit status of tax exemption and no capital requirements. Their products and services were limited in scope. This was acceptable so long as their field of membership restricted them from daily commerce with the community at large. This has changed, however, as evidenced by this advertisement that recently ran in the Orem Chamber of Commerce Newsletter for Orem Geneva Federal Credit Union. We've included this as exhibit B. The advertisement in part reads that now you and your employees can have a valuable benefit at no cost to your business. Membership in Orem Geneva Federal Credit Union is open to you and your employees and look at the advantages.

And then without reading those, it goes on to list about 19 services that are mostly bank services or at least common to banks with the exception of direct commercial loans——

Senator **Lautenberg**. And theater tickets, theater tickets at a discount.

Mr. **Higgins**. That's right, Senator. Field of membership and restriction of product and services, for all intent and purposes, no longer exists for credit unions. Another example is the Federal Employees Credit Union which is advertising that anyone in an eight-county area of Utah is eligible for membership. We've included this as exhibit C. This area represents where approximately 80 percent of Utah's population resides. We think that credit unions should pay their fair share of the tax burden and come under the same type of regulatory scrutiny and requirements for safety and soundness that exists for banking.

DEREGULATION AFFECTS EARNINGS OF BANKS

Deregulation thus far has brought many changes in the financial industry. For commercial banks it has, for the most part, affected the liability side of our balance sheet and the expense side of our income statement. We refer to such actions as the lifting of interest ceilings on certain types of deposits and the offering of NOW accounts, money market funds, and the like.

The deregulation of most types of deposits has put substantial pressure on the earnings of banks as interest rates have been adversely impacted.

I'd like to say a few words on deposits. We support the continued deregulation of deposits, specifically permitting payment of interest on nonpersonal transaction accounts. However, we believe that this should be phased in over a period of several years and not all at once. This will enable banks to reprice their assets so that the immediate impact on earnings would not be unduly severe.

In our opinion, the need for a phase-in is of particular importance to the smaller community banker.

I'd just like to make brief reference to the fair deposit availability. In our opinion, there is a great amount of misunderstanding concerning banks' policies and practices relating to deposit availability.

Among Utah banks, for which we can only speak, we are not convinced there has been abuse that warrants the enactment of legislation that will be restrictive, unworkable, and costly.

Since this issue became a popular topic of discussion, the banking industry has rapidly moved to take the necessary steps to explain and disclose bank policies and practices to their customers.

We are confident that our industry is willing and able to handle this matter in a manner that will be fair and equitable to the banks and customers alike.

We urge that section VI relating to this be stricken from the bill. This should remain a function of the marketplace.

Because of the limited time, I'll just say that credit card fraud, to summarize it, we couldn't be more for it. We would suggest if there's any change in this title that it should be on the side of severity and not easiness.

The CHAIRMAN. I'll put it in the record, so it does not appear that you are for credit card fraud. You said you are very much in favor of credit card fraud and the record should indicate you are in favor of the provisions in the bill that prohibits credit card fraud.

Mr. HIGGINS. Thank you, Senator. I wouldn't want to be on the record saying that. I'd be run out of the State, I believe.

Interest on reserve accounts, all banks that deal with the Fed have felt the impact of the Fed's new pricing policies. Many of us feel the Fed is in direct competition by offering correspondent bank services to our correspondent bank customers. The time has long since past when depository institutions that maintain reserves at the Federal Reserve Bank should begin earning a reasonable rate of interest on those reserve balances.

I will not discuss the holding company problems other than to say that we are very much in sympathy with Commissioner Weis' testimony on that. We feel that some size banks should be allowed to receive these new products and services without forming holding companies.

In conclusion, let me reiterate that now is the time to deregulate the asset side of the ledger by allowing us to offer the product and services proposed in Senator Garn's bill. This will be beneficial to our customers and consumers generally, as it will increase competition and give them a wider choice of financial services. As one of my banking colleagues recently stated: "We cannot allow banks to become the financial Ma and Pa stores of the 21st century, quaint relics from an earlier age." Therefore, we urgently request congressional action allowing the additional products and services that we need to better serve our customers. Any status quo or moratorium legislation is not the answer.

[The complete statement follows:]

ORAL
STATEMENT
OF
A. LAWRENCE HIGGINS

on behalf of
THE UTAH BANKERS ASSOCIATION

before the
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
Salt Palace, Suite "B"
Salt Lake City, Utah
January 16, 1984

Senator Garn, Secretary Regan, Chairman Volcker and other distinguished members of the hearing, my name is A. Lawrence Higgins. I am President of Continental Bank and Trust Company, an approximately 300 million dollar Commercial Bank located here in Salt Lake City. I am also President of the Utah Bankers Association. All full service national and state chartered banks in Utah are members of the Utah Bankers Association. The membership ranges in size from over two (2) billion in deposits on down. It is the Utah Bankers Association whom I represent today. We wish to thank you for this opportunity to appear.

We do not intend, nor could we in the time allotted, possibly comment on all of the proposals contained in Senator Garn's bill. However, as president of our association, I would like to convey to you some opinions and concerns of Utah Bankers pertaining to a few of these proposals. I can assure you that with very few exceptions, if any, Utah Bankers support the general thrust of the bill in the direction of new powers and services for commercial banks and greater competitive equity for all firms in the financial services industry. We are very much aware that what comes out of this committee, and eventually becomes law, probably will determine the way we bankers do business for years to come; perhaps, much like the banking legislation of the 1930's has done to this day.

For some time now, non-regulated financial institutions have entered our markets and offered to our customers a wide spectrum of financial services, many of which have traditionally been offered only by commercial banks. They have done so by squeezing through loopholes in present laws and regulations that were put in place to insure the safety and soundness of the nation's banking system. Traditionally, safety and soundness has been the hallmark of the banking industry and of primary concern of its regulators, and it should remain so. It should be uppermost in the minds of members of this committee in considering S.B. 2181, S.B. 2134 or any other banking legislation.

Certainly the safety and soundness of the nation's financial institutions is in the public's interest. Therefore, in our opinion you should take the necessary steps to close these loopholes to insure that any financial institution offering traditional bank services through such mediums as non-banks should meet the same criteria for safety and soundness as that prescribed for commercial banks.

We do not shrink from competition. We have proven in the past that we can aggressively compete when free to do so. A good example of this is the results when we were finally allowed to enter the money market funds competition.

Our franchise has been dangerously eroded by non-bank competition that is not subject to the same criteria of safety and soundness placed on banking. This non-bank competition operates outside of the regulatory constraints imposed upon our industry.

In addition, it is frustrating for us to see our traditional closely related competitors, such as savings and loans, thrifts and credit unions be given bank-like products and services, while the environment in which they operate is considerably less restrictive than banking. For instance, savings and loans, which under Garn St Germain received additional powers, have less stringent capital requirements and enjoy a federal regulator in the form of the Federal Home Loan Bank Board who is an advocate for their industry. Our regulator, the Federal Deposit Insurance Corporation, frequently and in some cases, the Federal Reserve Board and Comptroller take an adversary position to banking

Recently one of the major thrifts, Citicorp's Person-to-Person, with several outlets here in Utah, was granted the privilege to offer FDIC Insurance, announced in an article that ran in the Salt Lake Tribune, Saturday, January 7, 1984. The article indicates that to date Person to Person has 53 million in deposits and six offices in Utah (See attached Exhibit "A").

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Credit Unions once filled a void in the economy by providing an opportunity for individuals with a common field of membership to band together in a not for profit environment to afford them a convenient method for pooling savings and making loans for the benefit of their membership. Credit Unions, from their inception, have enjoyed special privileges through their non-profit status of tax exemption and no capital requirements. Their products and services were limited in scope. This was acceptable so long as their field of membership restricted them from daily commerce with the community at large. This has changed, however, as evidenced by this ad that recently ran in the Orem Chamber of Commerce Newsletter for Orem Geneva Federal Credit Union (See Exhibit "B"). The ad in part reads...

FREE EMPLOYEE BENEFIT!

NOW YOU AND YOUR EMPLOYEES CAN HAVE A VALUABLE BENEFIT
AT NO COST TO YOUR BUSINESS!
MEMBERSHIP IN OREM GENEVA FEDERAL CREDIT UNION IS OPEN
TO YOU AND YOUR EMPLOYEES AND LOOK AT THE ADVANTAGES!

- Low Cost Loans (car, home improvement, signature, etc.)
- FREE Checking -- no minimum balance, no service charges
- Lines of Credit
- 1st and 2nd Mortgages
- FHA Title 1 Home Improvement Loans
- 30 Year Mortgages
- Discount Theatre Tickets
- Student Loans
- Group Insurance
- Money Orders
- VISA Travelers Checks
- High Yield Certificates of Deposit
- Individual Retirement Accounts (IRA's)
- SEP-IRA's for Business
- Deposits Insured up to $100,000 by NCUA, an agency of the Federal
- Government
- Savings Accounts that pay up to 8%
- Coming Soon -- VISA Debit Card & Handibank ATM
  Drive-up Teller Service at Branch Office
  Night Deposit at Branch Office

OREM GENEVA FEDERAL CREDIT UNION
"YOUR COMMUNITY CREDIT UNION -- SERVING THE FAMILIES
AND BUSINESSES IN THE OREM GENEVA AREA"

Field of membership and restriction of product and services, for all intent and purposes, no longer exists for credit unions. Another example is the Federal Employees Credit Union which is advertising that anyone in an eight (8) county area of Utah is eligible for membership (See Exhibit "C"). This area represents 80% of Utah's population. It is time that credit unions pay their fair share of the tax burden and come under the same type of regulatory scrutiny and requirements that exists for banking.

Deregulation thus far has brought many changes in the financial industry, but for commercial banks it has, for the most part, affected the liability side of our balance sheet and the expense side of our income statement. We refer to such actions as the lifting of interest ceilings on certain types of deposit accounts, the offering of NOW accounts, money market funds, and the like.

The deregulation of most types of deposit accounts has put substantial pressure on the earnings of banks as interest spreads have been adversely impacted.

We support the continued deregulation of deposits, specifically permitting payment of interest on non-personal transaction accounts. However, we believe that this should be phased in over a period of several years - not all at once. This will enable banks to reprice their earning assets so that the immediate impact on earnings would not be unduly severe.

In our opinion, the need for a phase-in is of particular importance to the smaller community banker.

I'd like to make brief comments regarding (1) fair deposit availability, (2) credit card fraud, (3) interest on reserve accounts and (4) bank holding companies.

1. FAIR DEPOSIT AVAILABILITY

In our opinion, there is a great amount of misunderstanding concerning banks' policies and practices relating to deposit availability.

Among Utah banks, for which we can only speak, we are not convinced there has been abuse that warrants the enactment of legislation that would be restrictive, unworkable and costly.

Since this issue became a popular topic of discussion, the banking industry has rapidly moved to take the necessary steps to explain and disclose bank policies and practices to their customers.

We are confident that our industry is willing and able to handle this matter in a manner that will be fair and equitable to banks and bank customers alike.

We urge that Section VI relating to this be stricken from the bill. This should remain a function of the marketplace.

2. CREDIT CARD FRAUD

We strongly favor passage of Title IX relating to the fraudulent use of credit cards and debit cards.

Credit card fraud for many years has been a large expense to financial institutions and ultimately to the consuming public. The problem is escalating rapidly. It must be brought under control immediately. If any changes are made in this provision of the bill, we urge it be made on the side of more severity.

3. INTEREST ON RESERVE ACCOUNTS

All banks that deal with the Fed have felt the impact of the Fed's new pricing policies. Many of us feel the Fed is in direct competition by offering correspondent bank services to our correspondent bank customers. The time has long since past when depository institutions that maintain reserves at the Federal Reserve Bank should begin earning a reasonable rate of interest on such reserve balances.

4. BANK HOLDING COMPANIES

The requirement for all banks to form holding companies in order to offer new services is unnecessary and cannot be defended. Bank holding company subsidiaries do not necessarily assure removing the bank from potential risk. In some cases, the opposite could be true.

We urge you to allow adequately capitalized banks, within limits, to exercise new powers directly through the bank, a bank subsidiary or through separate holding company affiliates. Those limits should be at least, say up to 500 million in total assets and perhaps 10% maximum of those assets in the aggregate in newly authorized services.

In conclusion, let me reiterate that now is the time to deregulate the asset side of the ledger by allowing us to offer the product and services proposed in Senator Garn's bill. This will be beneficial to our customers and consumers generally, as it will increase competition and give to them a wider choice of financial services. As one of my banking colleagues recently stated, "we cannot allow banks to become the financial Ma and Pa stores of the twenty-first century, quaint relics from an earlier age". Therefore, we urgently request congressional action allowing the additional products and services that we need to better serve our customers. Status quo or moratorium legislation is not the answer.

I welcome the opportunity to respond to any questions you may have. Thank you.

Citicorp Center Gains FDIC Membership

Citicorp Person-to-Person Financial Center of Utah has been approved for membership in the Federal Deposit Insurance Corp., Dee Taylor, vice president of the Person-to-Person Financial Center in Salt Lake City, announced Friday.

Citicorp Person-to-Person, a thrift and loan, or industrial loan affiliate of Citicorp., New York-based bankholding company, has deposits of more than $53 million and six offices in Utah.

Federal legislation co-sponsored by Sen. Jake Garn, R-Utah, under the Garn-St Germain Bill of 1982, made it possible for industrial loan corporations to be eligible for FDIC coverage.

Membership in the FDIC, the federal agency which insures deposits of commercial and savings banks, means customer deposits are federally insured up to $100,000.

While Citicorp Person-to-Person automatically abandons its membership in the privately-sponsored Utah Industrial Loan Guaranty Corp., which backs deposits to $15,000, it maintains its pro-rata obligation in arrangements by ILGC in the acquisition of the former troubled Murray First Thrift and Loan by First Security Corp., Salt Lake City.

The ILGC particpaiton in either payments, deposits or guarantees approximated $10 million, of which Person-to-Person's participation was about $1.5 million., based on its percentage of deposits among the state's industrial loan companies, Mr. Taylor said.

Citicorp entered the industrial loan business in the early 1970s with acquisition of Nationwide Finance. It opened its Person-to-Person offices in Utah 10 years ago in former Nationwide Finance offices.

The
Salt Lake
Tribune
Business

Saturday Morning
January 7, 1984

Section B Page 10

OREM CHAMBER OF COMMERCE

LORNA MAYCOCK

Continued from Page 1

Lorna was born in Nephi on July 12, 1899. However, for all but nine years of her life, she has made Orem her city, and has called 468 South Main her home.

One of Orem's earliest dwellings, it has been restored and maintained; its orchards continue to produce, and an impressive row of pines along the lane preserve its name, Evergreen Acres.

Having received her teaching certificate from Brigham Young University, she has taught in Manti, Provo, and Orem schools.

Her marriage to Lawrence S. Maycock endears ten years beyond their Golden Anniversary. Proud, they are parents of Booth Maycock, Mrs. A Dean (Lorna Jean) Larsen, and Mrs. Thomas (Helen) Patten. They have 16 grandchildren and 20 great-grandchildren.

Thirty years at the bedside of her invalid mother nurtured Lorna's gift of compassion. Through comforting words at funerals, willing assistance and nourishing meals for friends, neighbors, church, and community, she cares!

Politically active, Lorna was delegate to the Utah County Women's Legislative Council. She served six years on their board and two terms as vice-president. When Arthur V. Watkins announced his decision to run for the U.S. Senate, Lorna invited Ivy Baker Priest to her home. There, in the company of interested friends, the Republican Women of Orem were organized. As their president, Lorna helped campaign until a late-night victory was declared: "The women of Orem elected a Senator!"

Her community interest expanding, she became charter member, later president of the Orem Women's Club, president of the Timpanogos First District Federated Women's Clubs, and charter member of the Spa. also, she's served two years on the Utah Valley Hospital Board of Directors, as representative on the Emeritus Board for BYU, and as board members for the Heritage Center.

With the Women's Club, she successfully lauched a project to add an art department at Lincoln High. Thirty years later, the school continues annual awards for outstanding artistic ability. The Club, also, have given an oil painting to the school; and they presented two paintings to the City Council for permanent display in the City center.

A 1933 supporter of the newly-organized Scera, she helped raise over $1,000 for furnishings.

AN ARMY OF MEDDLERS?

"For more than a generation now we have tried to solve out personal and social problems by taking them to lawyers, to government agencies and to Washington. As a result we now have armies of lawyers, gigantic government agencies and a gargantuan deficit generated in Washington. But it seems to me that our real problems have gotten bigger, not smaller, as a result of those activities."– William F. Ford, president of the Federal Reserve Bank of Atlanta.

FREE EMPLOYEE BENEFIT!

NOW YOU AND YOUR EMPLOYEES CAN HAVE A VALUABLE BENEFIT AT NO COST TO YOUR BUSINESS! MEMBERSHIP IN OREM GENEVA FEDERAL CREDIT UNION IS OPEN TO YOU AND YOUR EMPLOYEES AND LOOK AT THE ADVANTAGES!

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- FHA Title 1 Home Improvement Loans
- 30 Year Mortgages
- Discount Theatre Tickets
- Student Loans
- Group Insurance
- Money Orders
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- High Yield Certificates of Deposit
- Individual Retirement Accounts (IRA's)
- SEP-IRA's for Businesses
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- Government
- Savings Accounts that pay up to 8%
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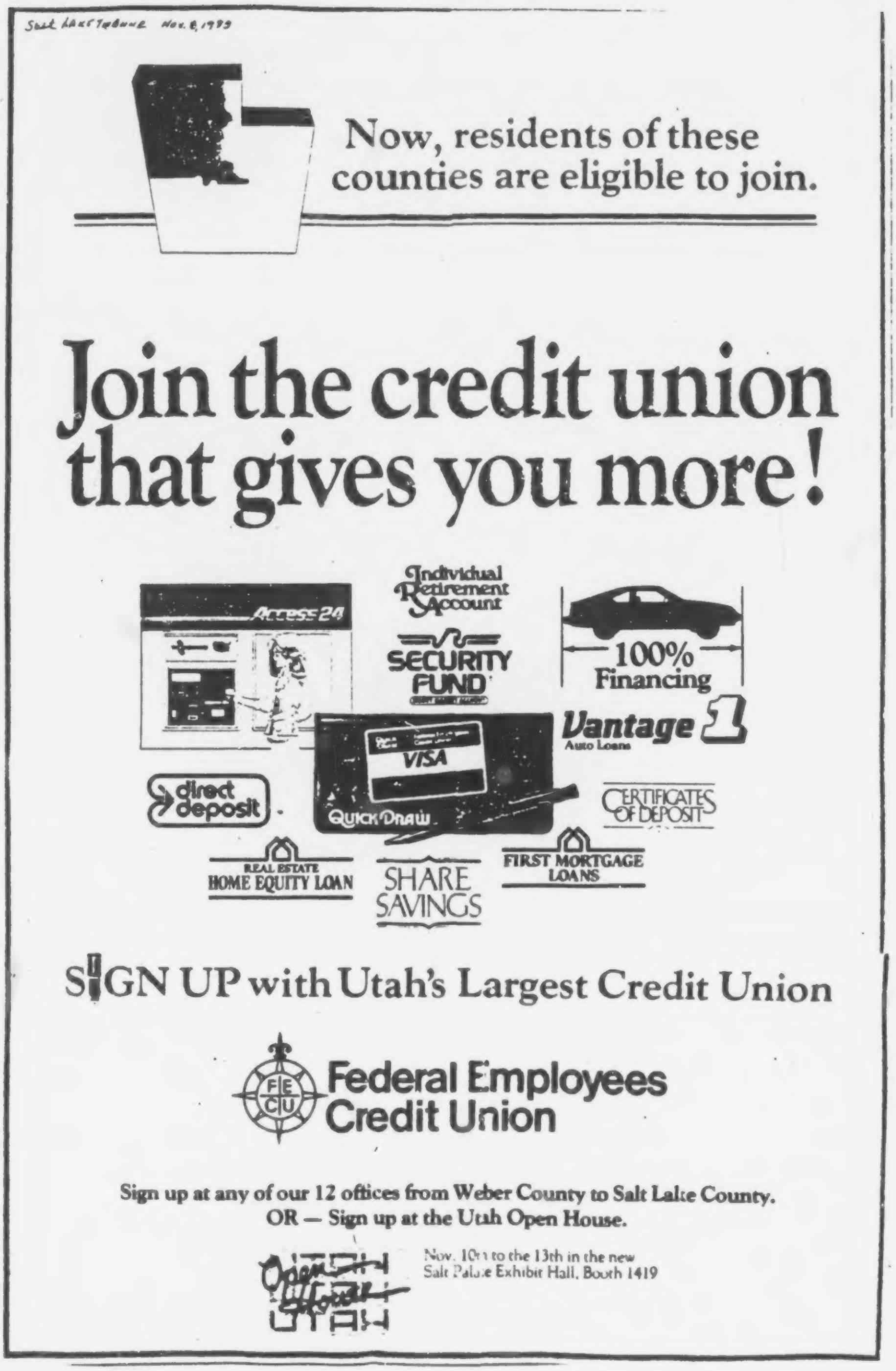
Call June at 225-6080 for more information on how you can enroll your company in the credit union's Select Employee Group.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HOME EQUITY LOAN
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FIRST MORTGAGE LOANS
Open House
UTAH

Salt Lake Tribune Nov. 8, 1989

Now, residents of these counties are eligible to join.

Join the credit union that gives you more!

SIGN UP with Utah's Largest Credit Union

Federal Employees Credit Union

Sign up at any of our 12 offices from Weber County to Salt Lake County.
OR — Sign up at the Utah Open House.

Nov. 10th to the 13th in the new
Salt Palace Exhibit Hall, Booth 1419

The CHAIRMAN. Mr. Christensen.

[EDITORIAL COMMENT: Whereupon, Mr. Christensen's testimony will be inserted into the record with the following changes: (1) Page 1, first paragraph should read: two billion twenty-three million dollars rather than twenty billion twenty-three million dollars. (2) On page 3, between the second and third paragraphs the following statement was inserted: "I was somewhat surprised to hear this morning Secretary Regan comment about the playing field which is new because that's what we have been talking about."]

[The complete statement follows:]

STATEMENT

GERALD R. CHRISTENSEN

President and Chairman of the Board

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF Salt Lake City

to the Field Hearings

of the Senate Banking, Housing and Urban Affairs Committee

on S. 2181, The Financial Services Competitive Equity Act

Chairman Garn:

I'm Jerry Christensen, President and Chairman of the Board of First Federal Savings and Loan here in Salt Lake City. I am also representing the Utah League of Insured Savings Institutions, which includes 13 members with combined Utah Assets of $2 billion, $23 million.

It's an honor, Mr. Chairman, to be invited to participate in today's hearings on your latest initiative to modernize the financial services industries. As you know, I'm active in savings institution groups across the country and, frankly, I'm proud to say: "Yes, the Jake Garn of the Garn-St.Germain Act, is MY Senator."

Though I'm quick to confess that I'm no lawyer and it's not easy to plow through the fine print in the Congressional Record, I think I understand this New Garn Bill well enough to say that it will be a major step forward in providing financial services to the American public.

From the savings and loan perspective, it would give us further encouragement to fulfill our primary role as home mortgage lenders. When the Garn-St. Germain bill became law, there was a lot of loose talk about savings institutions abandoning home finance because of the limited commercial and consumer lending investment opportunities you provided. The figures are just about in for 1983 --- and it is clear that we did not forsake home finance. Our mortgage lending nationwide should total $125 billion for the year -- $17 billion above the previous record set in 1978. At my own institution, First Federal, we increased our loan volume by 204% over 1982. This represents the most volume we've done in the last five years.

Furthermore, we are making some progress in working out from under one of our major sources of difficulty, our legacy of low-yielding mortgages. About 44% of our portfolio remains in loans earning less than 10% compared with 72% three years ago. And, nationwide, consumer acceptance is growing for the adjustable-rate mortgages which will give us a better chance to operate in future high-rate periods. Utah consumers are also accepting these adjustable rate loans. In my association, the volume during 1983 comprised 83% of adjustable rate mortgages. Incidentally, I was glad to see that you provided for some ARMs for the FHA program as part of the housing bill you enacted at the end of the last session. And, we are beginning to learn how to make commercial loans under the 10%-of-assets authority contained in Garn-St.Germain, though the totals thus far are not very significant. This is a well-established marketplace and it will take some time for savings institutions to penetrate it.

The preamble to Garn-St.Germain stated: "To revitalize the housing industry by strengthening the financial stability of home mortgage lending institutions and ensuring the availability of home mortgage loans." I'm optimistic that the purpose you set forth will be realized.

To me, the most impressive part of your new legislative proposal is the "qualified thrift lender" concept. As I understand it, your legislative design would look to the types of investments made by a financial institution in determining where it fits in our complex system of depository institutions. In particular, if a savings institution maintained 60% of its assets in "loans, equity positions and securities related to domestic residential real estate or manufactured housing, and property used in its business" it could continue to operate under the basic patterns for savings institutions rather than be pigeon-holed with commercial banking.

The housing-related, asset-composition approach is, in my opinion, an important vote of confidence in savings institutions and the job that they can do in providing mortgage loans for the homebuying public.

In particular, the housing-related test means that a stock institution which is part of a savings and loan holding company would retain the flexibility permitted under present law. It also means that service corporation activities of a federal association would not be disrupted by grandfathering restrictions found elsewhere in S. 2181. I hope that I am correct in saying that there is no new intention in this bill to tie the hands of the Federal Home Loan Bank Board. I appreciate, of course, the stiff instruction you gave regarding permissible service corporation activities to FHLB in your Committee Report at the time of Garn-St.Germain.

I would also hope that you might consider some minor alternations to the types of assets permitted in the 60% test. You include, for example, "property used in (the savings institution's) business". To operate a depository, we also must maintain some liquid investments at all times; the level is currently 5 ½ %. I would recommend that required liquidity investments count toward the 60% threshold. Some recognitition may also be appropriate for the savings institution which specializes in home lending but sells significant volumes in the secondary markets. Also, I understand that the bill introduced by your colleague, Senator Proximre, has a similar 60% test (for subsidiaries of diversified savings and loan holding companies), and that it would count the portion of our 3% service corporation investment which consists of domestic housing loans and related securities. That seems to me to be a reasonable change since those service corporation activities also accomplish the housing-related purpose. Though I realize it falls under the jurisdiction of another Committee, I would also hope that the Senate could update the tax definitional tests for savings institutions by setting the same standard for both savings banks and S&Ls, now that our institutions are virtually identical in their powers.

I know your time today is limited, but I would like to mention a few additional issues raised by S. 2181. The bill repeals the 50-year-old prohibition on the payment of interest on checking accounts. With NOW accounts nationwide today, that old prohibition is little more than a fiction and should be repealed. At the same time, I encourage you to complete the deposit deregulation process by removing the remaining barriers to full participation in deposit-taking by savings institutions. You will remember that commercial checking accounts at federal thrifts under present law are limited to customers with "established loan relationships." That makes it difficult to give full deposit service to businessmen who have reason to do busines with us everyday, such as a local realtor. When we find ourselves competing in the new deregulated marketplace against brokerage houses and commercial banks, I see no reason not to have full eligibility to accept demand deposits.

Your bill, Senator Garn, provides new securities powers, insurance activity, real estate investment and brokerage authorities to the affiliates of bank holding companies (and S&L holding companies with S&L subsidiaries which do not meet the qualified thrift lender test). I do not have any problem with this expansion of bank holding company authority. I do, however, have a recommendation on one, specific detail: I feel that the authority to underwrite and deal in mortgage-backed securities should not be reserved for just the affiliates of holding companies.

With your TIMs bill and your secondary market bill also pending in the Congress, we may be entering into a whole new way of raising credit for mortgage finance -- through wide availability of securities backed by pools of conventional home loans. A mutual savings institution, such as First Federal, would be severely handicapped if we had to convert to stock and form a holding company in order to participate fully in these innovative developments in home finance. It is also conceivable that these new tolls could be helpful in speeding the restructuring of our institutions through over-the-counter sales of securitized loan products. (The Federal

Home Loan Bank Board already possesses the delegated authority to apply the securities laws regarding broker practices and underwriting disclosures for the protection of the investing public.) I want to continue to participate fully in all aspects of housing finance, including these new products, and I ask you to consider a change to permit all federal associations -- not just those which are holding company affiliates -- to underwrite and deal in conventional mortgage-backed securities.

In another area, I am not convinced of the advisability of the creation of a whole new class of federally-insured depositories which this legislation classifies as "consumer banks." I realize that the non-bank bank loophole in the Bank Holding Company Act is a confusing problem for the Federal Reserve and is difficiult to address. However, inviting non-financial firms to set up these consumer banks with unlimited real estate investment and consumer loan operations seems to me to confuse the situation further.

Finally, let me ask whether these is any chance for relieving us from the massive paperwork burden of compliance with the Truth-in-Lending law on home loans? The supposed purpose of that complex requirement is to encourage shopping for loans. In the typical real estate transaction the buyer is already under contract when financing it sought and has the advice of a realtor who wants to see a sale consummated. However, under Garn-St. Germain, the realtor is declared by law not to be an "arranger of credit" -- which is certainly hard to fathom. All that the Truth-in-Lending law accomplishes in regards to real estate loans is a fee-producing opportunity for clever lawyers. Repeal it.

Thank you again for this opportunity to comment on your Financial Services Competitive Equity Act, Senator. We're proud of your leadership in addressing the needs of savings institutions for the benefit of the citizens of Utah and the country.

The **Chairman**. Thanks, very much.

Mr. Hawkes and Mr. Mobley.

STATEMENT OF R. BLAIR HAWKES, CHAIRMAN, LEGISLATIVE COMMITTEE, WESTERN INDEPENDENT BANKERS, ACCOMPANIED BY ROBERT MOBLEY, MEMBER, LEGISLATIVE COMMITTEE; AND JON C. BEDNERIK, EXECUTIVE DIRECTOR

Mr. **Hawkes**. My name is R. Blair Hawkes. I am legislative committee chairman of the Western Independent Bankers Association. Testifying with me today is Robert L. Mobley, a member of that committee. I am president of Ireland Bank in Malad City, Idaho, and Mr. Mobley is senior vice president of the Bank of A. Levy in Ventura, Calif. Mr. Mobley will begin our testimony.

Mr. **Mobley**. Western Independent Bankers is the only multi-State regional association of banks in the United States. Our membership consists of over 500 banks in the 13 States, of Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, and Wyoming.

Part of the special character of our organization comes from the makeup of our member banks—they are independent in operation and are closely in touch with the communities that they serve and are a part of.

WIB was founded in 1937 to foster a strong State and Federal dual banking system in the United States and to represent the viewpoint of the independent, community bankers located in the West.

Historically, State banking laws followed a more restrictive pattern in the other parts of the country and banking operations there tended to be more regimented. In the West, the small community banks had more wide-open competition. WIB members have faced the giant competitors in the marketplace. Through our members' ability to serve the local community and to effectively manage their banking operations, we have survived and grown.

It is the underlying belief of our membership that regulatory impediments and legislative imposed operational restrictions lead to artificial distortions of the marketplace. This seems always to lead to unfair advantages for some segment of the competition which then leads to further outside interference.

The WIB favors an atmosphere where the elements of service, management capability, and customer satisfaction are the keys to our success, not who has found and exploited the current legal loophole.

WIB urges this committee, the Congress, and the administration to complete the fullest and most rapid total decontrol of financial institutions that can be accomplished.

We believe that the public interest is best served and well protected by competent supervision and examinations carried out at the State and Federal levels.

We encourage early passage of the bill S. 2181 with some modification. The legislation should be treated as a package and efforts to deal with only a few of the provisions, while leaving others for later consideration, will diminish chances for enactment.

We await anxiously the report of the Vice President's Task Group on Regulation of Financial Services and hope that their legislative recommendations will further the early simplification of supervisory roles of the responsible agencies of Government.

CONSTANT RULE CHANGES CREATE UNNECESSARY DIFFICULTY AND EXPENSE

It seems to us that the constantly changing rules applied to banks and other financial institutions create unnecessary difficulty and expense in operations. We feel that the other types of financial institutions are frequently less burdened by legal requirements and regulations, at the same time they are competing for the same customers that we are. We do not fear the competition from the business world; we are frustrated by Government interference in our business operation.

Since S. 2181 generally moves toward deregulation, when taken as a whole, WIB supports the thrust of the legislation. But we do not feel that S. 2181 is sufficient to correct all existing problems nor moves far enough toward total deregulation.

There are several provisions which might be labeled decontrol, but which cause serious impact on us since other aspects of our operations are not freed from limitations.

Mr. HAWKES. Thank you.

TITLE I—FINANCIAL INSTITUTIONS COMPETITIVE EQUITY

The concept introduced in this legislation setting concentration limits—applicable to the largest 25 or so institutions to prohibit combinations of business entities—has not been considered by WIB before this time. While we appreciate the intention to somehow protect a segment of the industry such as ours, we are generally opposed to artificially contrived limitations being established. We do not embrace the view that largeness is inherently bad or that it adversely affects the public interest. We shall continue to examine this provision.

Our view of the definition of a "bank" is that the language of S. 1609 is preferred with regard to commercial loan transactions. We believe that the eligibility for FDIC insurance ought to be sufficient for the definition of a bank without regard to the "two-prong" test further provided in S. 2181.

As strong supporters of the dual banking system, we endorse the provisions calling for State approval.

WIB supports the granting of expanded powers for bank holding companies and further recommends that banks' outside holding companies be granted these powers. It is necessary to enlarge the services that such institutions can provide if they are to compete successfully in the present and future marketplace.

We approve of the proposed procedural changes to Federal Reserve Board action. We note that unitary savings and loan holding companies would continue to have no restrictions on nonsavings and loan activities under S. 2181. This is one area where the inequity of regulatory treatment should be corrected. Anything that gives one segment of the industry a favored status ought to be eliminated. WIB has taken no position yet on the section dealing with service corporations.

TITLE II—CREDIT UNION AMENDMENTS

We have some concern that credit unions should be treated equally with banks and other institutions, but have no specific comment on title II at this time. Credit unions have been accorded varying treatment under some State and Federal laws with respect to taxes and reserves.

TITLE III—BANKERS BANK

WIB supports, in concept, a strong bankers bank structure. We support the provision that a bank holding company can be a bankers bank and authorization for investment in exporting and trading companies.

TITLE IV—COMPETITIVE SAVINGS INCENTIVE

Regarding the payment to banks of interest on certain reserves, we are hesitant to endorse what might appear to be a beneficial provision. We believe that the Federal Reserve System should pay interest for the use of reserve funds held against all accounts. This, however, should not be taken as a specific trade-off against other sections of S. 2181 which would impact severely on our segment on the industry. Certainly big banks would benefit far more than our smaller, community institutions from the adoption of this language.

We support the provision, but point out that it is of limited value to independent, community banks.

TITLE V—CONSUMER LEASES AND RENTAL PURCHASE AGREEMENTS

It is our understanding that a number of amendments to this section are being drafted now. Leasing seems to have been somewhat more prominent in the West than other places and we shall work with the Members of Congress most active in the legislative development of this subject. When the additional amendments have been made available for us to review, we shall provide detailed comment on this section.

TITLE VI—FAIR DEPOSIT AVAILABILITY

The Western Independent Bankers oppose this section on specific grounds. The check clearance process in this country has developed over years and handles a staggering number of transactions each day as checks flow through the system. The need for placing holds on checks stems from the inherent delays in check return processes. As banking transactions have become more complex and customers have greater geographic interests the process has become more time consuming. The establishment of individual hold policies reflects the various collection delays that exist within the system. It is extremely difficult to announce a single hold policy since different transactions call for different processing times and many factors can affect the time required. Each bank is best able to determine how to acquaint its customers with this matter.

The great distances in the West between offices and between cities make the problem more difficult in our States.

We have urged and are urging our member banks to disclose to their customers their general hold policies and to draw attention to any specific hold that may be placed on an unusual transaction.

WIB opposes mandatory disclosure rules because we feel that such regulations may turn out to be unnecessarily complicated, expensive and may require a longer hold period to be set than are actually necessary to insure safety for the bank.

WIB members, who are themselves small- and medium-sized businesses, are not equipped to make the direct notification within 24 hours of determination of nonpayment for checks over $250. Many questions of procedure, adequate legal compliance, liability for error and the like make this provision to us unreasonable.

The mandated placement standard for endorsements could also prove difficult.

TITLE VII—CREDIT DEREGULATION AND AVAILABILITY

In keeping with our philosophy of deregulation, WIB favors the removal of interest rate ceilings on agricultural, business, and consumer loans. The preemption of State usury laws—with the preservation of the right of States to reject the preemption—accords with our view on dual bank regulation and further decontrol is an issue best left for marketplace determination.

TITLE VIII—INTEREST ON DEMAND DEPOSITS

This provision is one which has the potential for greatest impact on our member banks. Our opposition to this provision in Senate 2181 is based upon the fact that many other operating limitations and expensive operating procedures remain for independent banks. This provision represents a serious negative potential for our members until all other constrictions are removed from setting of rates, fees, and procedures, lines of business and such. We believe it will have a more severe impact on our size bank than on the larger institution. Their capabilities to analyze accounts, set charges, and command compensating balances are greater than ours. Furthermore, they have a better opportunity to purchase funds on a regular basis and the staff and time to do so, while many or our member banks do not; thus, our reliance on these noninterest-bearing accounts is greater. Small businesses can utilize various interest-bearing accounts now if they wish.

TITLE IX—FRAUDULENT USE OF CREDIT CARDS AND DEBIT CARDS

WIB applauds the inclusion of the provisions on abuses of credit cards.

TITLE X—INTERSTATE BANKING

WIB is a regional banking association. We believe that problems and solutions in banking and related services do not stop at the State line or any other geographical point. Our membership has not taken a position on the interstate banking issue, although we expect to be studying it closely in the coming months.

In all likelihood regional banking is the coming wave. Clearly, interstate banking is here today when all the fictions are stripped away.

For the vast majority of customers the distinctions that exist in the financial institutional framework of this Nation are rather meaningless. While the legal and accounting professions and the State and Federal regulators confront one another, the trade press covers the legal maneuvers that are part of the process today, the average person in the small town in the West wonders what all the fuss is about. If Sears has a Sears Savings Bank in its store or the local community bank is selling insurance or stock, it only means that more services are available from more sources.

We will compete successfully for the potential customer's business against fair competition. We can do so even with the ever-changing rules because we are an active part of our communities, we have the same values as our customers and we are active participants in the economic health of our service areas. Our customers know us; and we know them.

We are not afraid of competition. All we ask is a level playing field. We welcome early and complete deregulation so that we can get on with our business and serve our customers.

Senator LAUTENBERG. What size banks are in your organizations?

Mr. HAWKES. The largest is in the vicinity of $650 million.

Senator LAUTENBERG. The largest?

Mr. HAWKES. Yes.

[The complete statement follows:]

TESTIMONY
OF THE
WESTERN INDEPENDENT BANKERS

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We believe that the public interest is best served and well protected by competent supervision and auditing carried out at the state and Federal levels.

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Since S.2181 generally moves towards deregulation, when taken as a whole, WIB supports the thrust of the legislation. We do not feel that S.2181 is sufficient to correct all existing problems nor moves far enough towards total deregulation.

There are several provisions which might be labeled decontrol, but which would cause serious impact on us since other aspects of our operations are not freed from limitations.

Specific Comments on S.2181

TITLE I - FINANCIAL INSTITUTIONS COMPETITIVE EQUITY.

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Our view of the definition of a "Bank" is that the language of S.1609 is preferred with regard to commercial loan transactions. We believe that eligibility for FDIC insurance ought to be sufficient for the definition of a bank without regard to the "two prong" test further provided in S.2181.

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7

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We support the provision, but point out that it is of limited value to independent, community bankers.

TITLE V - COMSUMER LEASES AND RENTAL PURCHASE AGREEMENTS

It is our understanding that a number of amendments to this section are being drafted now. Leasing seems to have been somewhat more prominent in the West than other places and we shall work with the Members of Congress most active in the legislative development on this subject. When the additional amendments have been made available to us for review, we shall provide detailed comment on this section.

TITLE VI - FAIR DEPOSIT AVAILABILITY

Western Independent Bankers opposes this section on specific grounds. The check clearance process in this country has developed over years and handles a staggering number of transactions each day as checks move in the system. The need for placing holds on checks stems from the inherent delays in check return processes. As banking transactions have become more complex and customers have greater geographic interests the process has become more time-consuming. The establishment of individual hold policies reflect the various collection delays that exist within the system. It is extremely difficult to announce a single hold policy since different transactions call for different processing times and many factors can affect the time required. Each bank is best able to determine how to acquaint its customers with this matter.

Our great distances between offices and between cities make the problem more difficult in our states.

We urge our member banks to alert their customers to general hold policies and to draw attention to any specific hold that may be placed on unusual transactions.

WIB opposes mandatory disclosure rules because we feel that such regulations may turn out to be unnecessarily complicated, expensive and may require longer hold periods to be set than are actually necessary to insure a safety margin for the bank.

WIB members, who are themselves small and medium-sized businesses, are not equipped to make the direct notification within 24 hours of determination of nonpayment for checks over $250. Many questions of procedure, adequate legal compliance, liability for error and the like make this provision unreasonable.

The mandated placement standard for endorsements could prove difficult.

TITLE VII - CREDIT DEREGULATION AND AVAILABILITY

In keeping with our philosophy of deregulation, WIB favors the removal of interest rate ceilings on agricultural, business and consumer loans. The pre-emption of state usury laws (with the preservation of the right of states to reject the pre-emption), accords with our view on dual bank regulation and further decontrols an issue best left for marketplace determination.

TITLE VIII - INTEREST ON DEMAND DEPOSITS

This provision is one which has the potential for greatest impact on our member banks. Our opposition to this provision in S.2181 is based upon the fact that many other operating limitations and expensive operating procedures remain for independent banks. This provision represents a serious negative potential for our members until all other constrictions are removed from our setting of rates, fees, and procedures, lines of business and such. We believe it will have a more severe impact on our size bank then on larger institutions. Their capabilities to analyse accounts, set charges and command compensating balances are greater than ours. Furthermore, they have an opportunity to purchase funds on a regular basis and the staff and time to do so, while many of our member banks do not; thus, our reliance on these non interest bearing accounts is greater. Small businesses can now utilize various interest bearing accounts if they wish.

TITLE IX - FRAUDULENT USE OF CREDIT CARDS AND DEBIT CARDS

WIB applauds the inclusion of the provisions on abuses of credit cards.

TITLE X - INTERSTATE BANKING

WIB is a regional banking association. We believe that problems and solutions in banking and related services do not stop at the state line or any other geographic point. Our membership has not taken a position on the interstate banking issue, although we expect to be studying it closely in the coming months.

In all likelihood regional banking is the coming wave. Clearly, interstate banking is here today when all the fictions are stripped away.

For the vast majority of customers the distinctions that exist in the financial institutional framework of this nation are rather meaningless. While the legal and accounting professions and the state and Federal regulators confront one another, and the trade press covers the legal maneuvers that are part of the process today, the average person in the small town in the West wonders what all the fuss is about. If Sears has a Sears Savings Bank in its store or the local community bank is selling insurance or stock, it only means that more services are available from more sources.

We will compete successfully for that potential customer's business against fair competition. We can do so even with ever-changing rules because we are part of our community, we have the same values as our customers and we are active participants in the economic health of our service areas. Our customers know us; we know them.

We are not afraid of competition. We welcome early and complete deregulation so that we can get on with our businesses and serve our customers.

The CHAIRMAN. Don Bleazard.

STATEMENT OF DONALD W. BLEAZARD, PRESIDENT, UTAH CREDIT UNION LEAGUE, INC.

Mr. BLEAZARD. Good afternoon. My name is Donald W. Bleazard. I am the president of the Utah Credit Union League. We appreciate the opportunity to testify today.

There are those who believe that like powers make for like institutions and that achieving the proverbial level playing field leads to the homogenization of all financial institutions. We, in credit unions, disagree. It is philosophy, not powers, which differentiate financial institutions. Credit unions are, as always, member-owned cooperative financial institutions. They are democratically controlled with each individual member of the credit union having only one vote despite the number of shares on deposit in the credit union. The very structure of the credit union insures that every penny earned in excess of operating expenses, reserves, and undivided earnings is returned to our member-owners.

CREDIT UNIONS AND THE 98TH CONGRESS

Meeting the savings and borrowing needs of our members remains the prime goal of the credit union movement. We do not want to become retailers, manufacturers, mutual funds or insurers. It is for this reason that we asked to be left out of the recent Treasury Department's legislative proposal, the Financial Institutions Deregulation Act [FIDA]. Since we are not seeking any authority that changes the basic structure of credit unions, we do not believe credit union activities should be brought to a halt simply because there are those in the financial community who want to alter their traditional roles. We are also concerned with the various moratoria proposals because we have not been able to determine precisely what types of credit union activities they may cover.

Similarly, we are anxious that any effort to curtail the expansion of banks' interstate activities should not limit the traditional ability of credit unions to serve their members who live in different parts of the country or the world, for that matter. Certainly any effort to impose such restraints—where they have never existed in the past—would be opposed by the movement.

S. 2181 AND S. 2134

Traditionally, the credit union movement has not commented on legislative proposals that do not have a direct impact on credit unions. In the past we have not opposed the changes sought by our competitors, but instead concentrated on developing new ways to better serve our members. We see no reason to alter that position with regard to pending legislation. Be assued that Utah credit union representatives will participate in discussions of the competitive impact of many of the proposals embodied in both bills at our upcoming governmental affairs conference in early February. We will forward to you any concerns that we have after that meeting.

TITLE II—CREDIT UNION PROVISIONS

None of the proposals contained in title II radically alters credit union activities. They simply allow more flexibility in our operations. The first of these proposals grants us second mortgage lending parity with other lenders and allows for extension of a loan rather than requiring higher monthly payments or a balloon payment. No time restriction on second mortgate loans is imposed by Utah law and no identifiable problems are known to have been caused by excessive second mortgage maturities. Consequently, the second mortgage loans amendment allowing the NCUA board to extend loan maturities should be adopted.

The second proposal gives credit unions the option of offering members a new kind of ownership in the credit union. It is designed to create a source of capital which would supply many of the features that capital traditionally offers other types of financial institutions. For example, it would provide a cushion for losses, a base for future growth and enable credit unions to meet competitive pressures as they arise.

The concept of a membership share was one of a number of recommendations made by the National Credit Union System Capitalization Commission. Some 300 credit union officials, representing credit unions of all sizes and types from across the Nation, participated in the commission.

The third proposal eliminates the "faithful performance" bond requirement. We believe fraud and defalcation bond protection for credit unions continues to be essential. However, recent court decisions applying a negligence standard in a faithful performance context have adversely affected credit unions. A continued requirement for faithful performance protection tends to reward poor management and control practices and causes bond premiums to skyrocket. Adequate protection for credit unions will be provided if fidelity coverage—not faithful performance coverage—is required.

Most of the other amendments are technical in nature. However, this does not minimize their importance to us.

TITLE IV—INTEREST ON RESERVES

Credit unions support the interest on reserves provisions in title IV of S. 2181. The money market deposit account mandated by the Garn-St Germain Act was intended to be directly equivalent to and competitive with money market mutual funds. However, the deposit account cannot be rate competitive with money market funds because reserve requirements imposed on the account will prevent depository institutions from offering fully competitive rates, thereby imposing a rate penalty on holders of the account. Paying interest on reserves would help alleviate this inequity.

TITLE VI—DELAYED FUNDS AVAILABILITY

There appears to be a growing interest nationwide concerning deposit hold practices that financial institutions utilize. Some depositories delay funds availability 15 to 20 days to allow for the clearing, settlement, and possible return of cash items. Utah credit unions support efforts to protect consumers from unfair or deceptive practices. Consequently, we support the concept of title VI. Nationally, CUNA is conducting additional work to determine how best to protect the consumer in this area. I'm sure that results of this work will be made available to the committee by CUNA.

TITLE VII—USURY PREEMPTION

Interest rate ceilings generally and State interest ceilings on consumer credit transactions in particular involve issues which are fundamental to the concepts of self-management and democratic control on which credit unions are based. A credit union is organized to provide its members an opportunity to use and control their own money on a democratic basis in order to improve their economic and social condition. As financial cooperatives, each credit union should be free to run its own affairs according to the needs of its members.

In Utah, the 1983 legislature eliminated the usury ceiling for open-end credit. Our experience thus far has been positive and has been accepted by the consumers.

Each credit union should be able to decide what loan rates to charge its member-borrowers.

TITLE IX—CREDIT AND DEBIT CARD FRAUD

The proliferation of credit cards and debit cards has increased the use and duplication of credit cards. Annual dollar losses in the billions are mounting and Federal consumer and criminal laws are presently insufficient to deal with the problems. Credit unions support efforts to tighten Federal laws with regard to counterfeiting and other fradulent use of credit cards and credit card numbers.

S. 2122—PAYROLL ALLOTMENT FEE ELIMINATION

The changes this legislation would make bring the civilian employee payroll practices of the Federal Government in line with the private sector and other Federal employee payroll practice. Allotments are the lifeblood of the savings program of most military and civilian employees. Allotments are earmarked for special purposes, such as savings, particularly the funding of IRA accounts. Payroll deduction is an important and effective way to have employees manage their savings programs.

Credit unions support the Payroll Deduction Facilitation Act because it addresses an inequity in the current system. A military and civilian member working side by side and having similar allotments find their credit union having to pay to receive the civilian allotment but not the military one.

S. 2120—THE TAX EXEMPT STATUS FOR THE CLF

We support this legislation which will correct an oversight in the enactment of legislation for the Central Liquidity Facility [CLF]. The CLF is a central bank for credit unions, is a mixed ownership corporation, is on-budget, and is located within the National Credit Union Administration, an independent Government agency. Consequently, the CLF's tax status should be clarified.

S. 2121—CAPITALIZATION OF THE NATIONAL CREDIT UNION SHARE INSURANCE FUND

Today, credit unions, like other financial institutions, are vulnerable in new, unremitting ways to the uncertainties of the marketplace. These range from events like strikes and plant closings that are by their nature unpredictable to foreseeable threats from large financial conglomerates. The list of challenges could go on and on.

One vital hedge against the unknown is the national credit union share insurance fund [NCUSIF]. The credit union is underfunded, in both relative and absolute terms. Unlike the other funds which protect depositors—FDIC and FSLIC—the NCUSIF was begun 12 years ago without any capital infusion from the Federal Government. The bank and savings and loan insurance funds were created in the 1930's and capitalized with Government seed money.

At present, the ratio of dollars in the credit union fund to insured shares is only three-tenths of 1 percent—a level that has remained fairly constant for the last several years. Although the dollars in the fund have grown substantially, this growth hasn't been fast enough to keep pace with insured shares. Since it is this ratio—fund assets as a percentage of insured shares—that counts in determining the strength of the fund as a safety net, the credit union fund isn't up to par. We believe that a minimum of 1 percent capital is needed.

The bill provides for a 1-percent deposit to be placed in the share insurance fund by all insured credit unions. It also grants NCUA discretion to phase-in the deposit obligation over a number of years. Utah credit unions believe that a phase-in is essential and will strongly urge NCUA to adopt this policy if the bill is adopted. However, because credit unions now have substantial liquidity, the funding of the national credit union share insurance fund should begin now.

CONCLUSION

Utah credit unions welcome the committee to Utah and appreciate the opportunity to appear at these hearings. It is our hope that this committee's track record in the 98th Congress is as productive as it was in the 97th. We encourage this committee in its work and look forward to assisting you in whatever way possible in the legislative process to come.

[The complete statement follows:]

TESTIMONY

OF

DONALD W. BLEAZARD

PRESIDENT

UTAH CREDIT UNION LEAGUE, INC.

BEFORE

THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

OF THE

UNITED STATES SENATE

JANUARY 16, 1984

The Utah Credit Union League is a trade association of Utah credit unions. The League represents 245 credit unions including 60 federally chartered credit unions and 185 state chartered credit unions. Sixteen state chartered credit unions are federally insured. These credit unions serve approximately 650,000 members. Credit unions are cooperative, non-profit associations that offer various financial services to their members. The League is an affiliate of the Credit Union National Association (CUNA), an association representing more than 20,000 credit unions nationwide.

GOOD MORNING. MY NAME IS DONALD W. BLEAZARD. I AM PRESIDENT OF THE UTAH CREDIT UNION LEAGUE. SOME OF MY COMMENTS TODAY ALSO REFLECT THE POSITION OF THE CREDIT UNION NATIONAL ASSOCIATION.

CREDIT UNION OPERATIONS IN UTAH

CREDIT UNIONS CONTINUE TO PROVIDE OUTSTANDING FINANCIAL SERVICES TO APPROXIMATELY 650,000 UTAHNS. THESE 650,000 MEMBERS ARE ABOUT 1/2 OF ALL UTAHNS. TO THE BEST OF OUR KNOWLEDGE AND INFORMATION, NO CREDIT UNION MEMBER HAS LOST ANY DEPOSITS IN ANY UTAH CREDIT UNION. YEAR-END DATA HAS NOT BEEN FULL COMPILED; HOWEVER, IT APPEARS THAT TOTAL SHARES AND DEPOSITS AT THE END OF 1983 IN UTAH CREDIT UNION EXCEED $1.1 BILLION. TOTAL ASSETS HELD BY UTAH CREDIT UNIONS EXCEED $1.2 BILLION AND TOTAL LOANS EXCEED $750,000,000.

NATIONWIDE, TOTAL ASSETS OF CREDIT UNIONS EXCEED $100 BILLION. CREDIT UNIONS NOW PROVIDE SERVICES TO MORE THAN 48 MILLION MEMBERS.

DEREGULATION HAS PROVIDED CHALLENGES AS WELL AS OPPORTUNITIES. IN TODAY'S FINANCIAL MARKETPLACE, MANAGERS AND VOLUNTEER BOARDS MUST BE SHARPER, BETTER BUSINESSMEN AND WOMEN THAN IN THE PAST. THEY MUST BE MORE RESPONSIBLE TO THE NEEDS OF THE MEMBERS WHO OWN AND CONTROL THEIR CREDIT UNIONS.

THERE ARE THOSE WHO BELIEVE THAT LIKE POWERS MAKE FOR LIKE INSTITUTIONS AND THAT ACHIEVING THE PROVERBIAL LEVEL PLAYING FIELD LEADS TO THE HOMOGENIZATION OF ALL FINANCIAL INSTITUTIONS. WE, IN CREDIT UNIONS, DISAGREE. IT IS PHILOSOPHY NOT POWERS WHICH DIFFERENTIATE FINANCIAL INSTITUTIONS. CREDIT UNIONS ARE, AS ALWAYS, MEMBER-OWNED COOPERATIVE FINANCIAL INSTITUTIONS. THEY ARE DEMOCRATICALLY CONTROLLED WITH EACH INDIVIDUAL MEMBER OF THE CREDIT UNION HAVING ONLY ONE VOTE DESPITE THE NUMBER OF SHARES ON DEPOSIT IN THE CREDIT UNION. THE VERY STRUCTURE OF THE CREDIT UNION INSURES THAT EVERY PENNY EARNED IN EXCESS OF OPERATING EXPENSES, RESERVES AND UNDIVIDED EARNINGS IS RETURNED TO OUR MEMBER-OWNERS.

CREDIT UNIONS AND THE 98TH CONGRESS

MEETING THE SAVINGS AND BORROWING NEEDS OF OUR MEMBERS REMAINS THE PRIME GOAL OF THE CREDIT UNION MOVEMENT. WE DO NOT WANT TO BECOME RETAILERS, MANUFACTURERS, MUTUAL FUNDS OR INSURERS. IT IS FOR THIS REASON THAT WE ASKED TO BE LEFT OUT OF THE RECENT TREASURY DEPARTMENT'S LEGISLATIVE PROPOSAL, THE FINANCIAL INSTITUTIONS DEREGULATION AACT (FIDA). SINCE WE ARE NOT SEEKING ANY AUTHORITY THAT CHANGES THE BASIC STRUCTURE OF CREDIT UNIONS, WE DO NOT BELIEVE CREDIT UNION ACTIVITIES SHOULD BE BROUGHT TO A HALT SIMPLY BECAUSE THERE ARE THOSE IN THE FINANCIAL COMMUNITY WHO WANT TO ALTER THEIR TRADITIONAL

ROLES. WE ARE ALSO CONCERNED WITH THE VARIOUS MORATORIA PROPOSALS BECAUSE WE HAVE NOT BEEN ABLE TO DETERMINE PRECISELY WHAT TYPES OF CREDIT UNION ACTIVITIES THEY MAY COVER.

SIMILARLY, WE ARE ANXIOUS THAT ANY EFFORT TO CURTAIL THE EXPANSION OF BANKS' INTERSTATE ACTIVITIES SHOULD NOT LIMIT THE TRADITIONAL ABILITY OF CREDIT UNIONS TO SERVE THEIR MEMBERS WHO LIVE IN DIFFERENT PARTS OF THE COUNTRY OR THE WORLD, FOR THAT MATTER. CERTAINLY ANY EFFORT TO IMPOSE SUCH RESTRAINTS--WHERE THEY HAVE NEVER EXISTED IN THE PAST--WOULD BE OPPOSED BY THE MOVEMENT.

S. 2181 AND S. 2134

TRADITIONALLY, THE CREDIT UNION MOVEMENT HAS NOT COMMENTED ON LEGISLATIVE PROPOSALS THAT DO NOT HAVE A DIRECT IMPACT ON CREDIT UNIONS. IN THE PAST WE HAVE NOT OPPOSED THE CHANGES SOUGHT BY OUR COMPETITORS, BUT INSTEAD CONCENTRATED ON DEVELOPING NEW WAYS TO BETTER SERVE OUR MEMBERS. WE SEE NO REASON TO ALTER THAT POSITION WITH REGARD TO PENDING LEGISLATION. BE ASSURED THAT UTAH CREDIT UNION REPRESENTATIVES WILL PARTICIPATE IN DISCUSSIONS OF THE COMPETITIVE IMPACT OF MANY OF THE PROPOSALS EMBODIED IN BOTH BILLS AT OUR UPCOMING GOVERNMENTAL AFFAIRS CONFERENCE IN EARLY FEBRUARY. BE ASSURED, TOO, THAT WE WILL FORWARD TO YOU ANY CONCERNS THAT WE HAVE AFTER THAT MEETING.

TITLE II: CREDIT UNION PROVISIONS

NONE OF THE PROPOSALS CONTAINED IN TITLE II OF S. 2181 RADICALLY ALTERS CREDIT UNION ACTIVITIES. THEY ARE A FURTHER REFINEMENT OF CREDIT UNION EFFORTS TO ALLOW MORE FLEXIBILITY IN OUR OPERATIONS. THE FIRST OF THESE PROPOSALS GRANTS US SECOND MORTGAGE LENDING PARITY WITH OTHER LENDERS AND ALLOWS FOR EXTENSION OF A LOAN RATHER THAN REQUIRING HIGHER MONTHLY PAYMENTS OR A BALLOON PAYMENT. LENDING POLICIES AND PROCEDURES SHOULD BE ESTABLISHED BY CREDIT UNIONS SUBJECT TO GENERAL GUIDELINES ESTABLISHED BY THE NCUA BOARD. NO TIME RESTRICTION ON SECOND MORTGAGE LOANS IS IMPOSED BY UTAH LAW AND NO IDENTIFIABLE PROBLEMS ARE KNOWN TO HAVE BEEN CAUSED BY EXCESSIVE SECOND MORTGAGE MATURITIES. CONSEQUENTLY, THE SECOND MORTGAGE LOANS AMENDMENT ALLOWING THE NCUA BOARD TO EXTEND LOAN MATURITIES SHOULD BE ADOPTED.

THE SECOND PROPOSAL GIVES CREDIT UNIONS THE OPTION OF OFFERING MEMBERS A NEW KIND OF OWNERSHIP IN THE CREDIT UNION. IT IS DESIGNED TO CREATE A SOURCE OF CAPITAL WHICH WOULD SUPPLY MANY OF THE FEATURES THAT CAPITAL TRADITIONALLY OFFERS OTHER TYPES OF FINANCIAL INSTITUTIONS: FOR EXAMPLE, IT WOULD PROVIDE A CUSHION FOR LOSSES, A BASE FOR FUTURE GROWTH AND ENABLE CREDIT UNIONS TO MEET COMPETITIVE PRESSURES AS THEY ARISE.

THE CONCEPT OF A MEMBERSHIP SHARE WAS ONE OF A NUMBER OF RECOMMENDATIONS MADE BY THE NATIONAL CREDIT UNION SYSTEM

CAPITALIZATION COMMISSION. SOME 300 CREDIT UNION OFFICIALS, REPRESENTING CREDIT UNIONS OF ALL SIZES AND TYPES FROM ACROSS THE NATION, PARTICIPATED IN THE COMMISSION.

THE THIRD PROPOSAL ELIMINATES THE "FAITHFUL PERFORMANCE" BOND REQUIREMENT. WE BELIEVE FRAUD AND DEFALCATION BOND PROTECTION FOR CREDIT UNIONS CONTINUES TO BE ESSENTIAL. HOWEVER, RECENT COURT DECISIONS APPLYING A NEGLIGENCE STANDARD IN A FAITHFUL PERFORMANCE CONTEXT HAVE ADVERSELY AFFECTED CREDIT UNIONS. A CONTINUED REQUIREMENT FOR FAITHFUL PERFORMANCE PROTECTION TENDS TO REWARD POOR MANAGEMENT AND CONTROL PRACTICES AND CAUSES BOND PREMIUMS TO SKYROCKET. ADEQUATE PROTECTION FOR CREDIT UNIONS WILL BE PROVIDED IF FIDELITY COVERAGE (NOT FAITHFUL PERFORMANCE COVERAGE) IS REQUIRED.

MOST OF THE OTHER OF THESE AMENDMENTS ARE TECHNICAL IN NATURE. THIS DOES NOT MINIMIZE THEIR IMPORTANCE TO US. FOR EXAMPLE, ONE AMENDMENT WOULD MAKE IT EASIER FOR A CREDIT UNION TO CONVERT FROM FEDERAL TO OTHER DEPOSIT INSURANCE. THIS PROVISION IS KEY TO RETAINING THE DUAL--FEDERAL-STATE--CREDIT UNION SYSTEM. THIS CHANGE CONFORMS TO THE CHARTER CONVERSION PROVISION OF THE GARN-ST GERMAIN ACT WHICH REQUIRES, AMONG OTHER THINGS, THAT FULL DISCLOSURE BE MADE OF ANY DESIRED CHANGE AND THAT IT BE RATIFIED BY THE MEMBERSHIP.

TITLE IV: INTEREST ON RESERVES

CREDIT UNIONS SUPPORT THE INTEREST ON RESERVES PROVISIONS

IN TITLE IV OF S. 2181. THE MONEY MARKET DEPOSIT ACCOUNT MANDATED BY THE GARN-ST GERMAIN ACT WAS INTENDED TO BE DIRECTLY EQUIVALENT TO AND COMPETITIVE WITH MONEY MARKET MUTUAL FUNDS. HOWEVER, THE DEPOSIT ACCOUNT CANNOT BE RATE COMPETITIVE WITH MONEY MARKET FUNDS BECAUSE RESERVE REQUIREMENTS IMPOSED ON THE ACCOUNT WILL PREVENT DEPOSITORY INSTITUTIONS FROM OFFERING FULLY COMPETITIVE RATES, THEREBY IMPOSING A RATE PENALTY ON HOLDERS OF THE ACCOUNT. PAYING INTEREST ON RESERVES WOULD HELP ALLEVIATE THIS INEQUITY.

TITLE VI: DELAYED FUNDS AVAILABILITY

THERE APPEARS TO BE GROWING INTEREST NATIONWIDE CONCERNING DEPOSIT HOLD PRACTICES THAT FINANCIAL INSTITUTIONS UTILIZE. SOME DEPOSITORIES DELAY FUNDS AVAILABILITY 15-20 DAYS TO ALLOW FOR THE CLEARING, SETTLEMENT AND POSSIBLE RETURN OF CASH ITEMS. UTAH CREDIT UNIONS SUPPORT EFFORTS TO PROTECT CONSUMERS FROM UNFAIR OR DECEPTIVE PRACTICES. CONSEQUENTLY, WE SUPPORT THE CONCEPT OF TITLE VI OF S. 2181. NATIONALLY, CUNA IS CONDUCTING ADDITIONAL WORK TO DETERMINE HOW BEST TO PROTECT THE CONSUMER IN THIS AREA. I'M SURE THAT RESULTS OF THIS WORK WILL BE MADE AVAILABLE TO THE COMMITTEE BY CUNA.

TITLE VII: USURY PREEMPTION

INTEREST RATE CEILINGS GENERALLY AND STATE INTEREST CEILINGS ON CONSUMER CREDIT TRANSACTIONS IN PARTICULAR INVOLVE

ISSUES WHICH ARE FUNDAMENTAL TO THE CONCEPTS OF SELF-MANAGEMENT AND DEMOCRATIC CONTROL ON WHICH CREDIT UNIONS ARE BASED. A CREDIT UNION IS ORGANIZED TO PROVIDE ITS MEMBERS AN OPPORTUNITY TO USE AND CONTROL THEIR OWN MONEY ON A DEMOCRATIC BASIS IN ORDER TO IMPROVE THEIR ECONOMIC AND SOCIAL CONDITION. AS FINANCIAL COOPERATIVES, EACH CREDIT UNION SHOULD BE FREE TO RUN ITS OWN AFFAIRS ACCORDING TO THE NEEDS OF ITS MEMBERS.

IN UTAH, THE 1983 LEGISLATURE ELIMINATED THE USURY CEILING FOR OPEN END CREDIT. OUR EXPERIENCE THUS FAR HAS BEEN POSITIVE AND HAS BEEN ACCEPTED BY CONSUMERS.

EACH CREDIT UNION SHOULD BE ABLE TO DECIDE WHAT INTEREST RATE TO PAY ITS MEMBER-SAVERS AND WHAT LOAN RATES TO CHARGE ITS MEMBER-BORROWERS.

TITLE IX: CREDIT AND DEBIT CARD FRAUD

THE PROLIFERATION OF CREDIT CARDS AND DEBIT CARDS THROUGHOUT THE NATION HAS ALSO BROUGHT ILLICIT ACTIVITIES WITH REGARD TO THE USE AND DUPLICATION OF CREDIT CARDS. ANNUAL DOLLAR LOSSES IN THE BILLIONS ARE MOUNTING AND FEDERAL CONSUMER AND CRIMINAL LAWS ARE PRESENTLY INSUFFICIENT TO DEAL WITH THE PROBLEMS. CREDIT UNIONS SUPPORT EFFORTS TO TIGHTEN FEDERAL LAWS WITH REGARD TO COUNTERFEITING AND OTHER FRAUDULENT USE OF CREDIT CARDS AND CREDIT CARD NUMBERS.

S. 2122: PAYROLL ALLOTMENT FEE ELIMINATION

THE PAYROLL DEDUCTION FACILITATION ACT (S. 2122) WOULD ELIMINATE FEES FOR PAYROLL ALLOTMENTS. THE CHANGES THIS LEGISLATION WOULD MAKE BRING THE CIVILIAN EMPLOYEE PAYROLL PRACTICES OF THE FEDERAL GOVERNMENT IN LINE WITH THE PRIVATE SECTOR AND OTHER FEDERAL EMPLOYEE PAYROLL PRACTICE. ALTHOUGH IT IS DIFFICULT TO DETERMINE THE IMPACT OF THESE CHANGES ON SAVINGS, IT IS CERTAIN THAT THE COST OF THESE ALLOTMENTS TO THE CREDIT UNIONS CAN BE RETURNED TO THE MEMBERS IN THE FORM OF INCREASED DIVIDENDS AND LOWER COST LOANS. ALLOTMENTS ARE THE LIFEBLOOD OF THE SAVINGS PROGRAMS OF MOST MILITARY AND CIVILIAN EMPLOYEES. NOW, 97% OF THE MORE THAN 1,100 CREDIT UNIONS SERVING MEMBERS OF THE MILITARY AND FEDERAL CIVILIANS RECEIVE SOME TYPE OF ALLOTMENT. ALLOTMENTS ARE EARMARKED FOR SPECIAL PURPOSES, SUCH AS SAVINGS, PARTICULARLY THE FUNDING OF IRA ACCOUNTS. PAYROLL DEDUCTION IS AN IMPORTANT AND EFFECTIVE WAY TO HAVE EMPLOYEES MANAGE THEIR SAVINGS PROGRAMS.

CREDIT UNIONS SUPPORT THE PAYROLL DEDUCTION FACILITATION ACT BECAUSE IT ADDRESSES AN INEQUITY IN THE CURRENT SYSTEM. THE PRESENT POLICY IS PARTICULARLY OBVIOUS AND INCONSISTENT IN THE DEFENSE CREDIT UNIONS. A MILITARY AND A CIVILIAN MEMBER WORKING SIDE BY SIDE AND HAVING SIMILAR ALLOTMENTS FIND THEIR CREDIT UNION HAVING TO PAY TO RECEIVE THE CIVILIAN ALLOTMENT BUT NOT THE MILITARY ONE.

S. 2120: TAX EXEMPT STATUS FOR THE CLF

WE SUPPORT THIS LEGISLATION WHICH WILL CORRECT AN OVERSIGHT IN THE ENACTMENT OF P.L. 95-630 REGARDING THE CENTRAL LIQUIDITY FACILITY (CLF). IT IS OUR UNDERSTANDING THAT THE TREASURY HAS NO OBJECTION TO THIS CORRECTION. THE CLF IS A CENTRAL BANK FOR CREDIT UNIONS, IS A MIXED OWNERSHIP CORPORATION, IS ON-BUDGET, AND IS LOCATED WITHIN THE NATIONAL CREDIT UNION ADMINISTRATION, AN INDEPENDENT GOVERNMENT AGENCY. CONSEQUENTLY, THE CLF'S TAX STATUS SHOULD BE CLARIFIED.

S. 2121: CAPITALIZATION OF THE NATIONAL CREDIT UNION SHARE INSURANCE FUND

TODAY, CREDIT UNIONS, LIKE OTHER FINANCIAL INSTITUTIONS, ARE VULNERABLE IN NEW, UNREMITTING WAYS TO THE UNCERTAINTIES OF THE MARKETPLACE. THESE RANGE FROM EVENTS LIKE STRIKES AND PLANT CLOSINGS THAT ARE BY THEIR NATURE UNPREDICTABLE TO FORESEEABLE THREATS FROM LARGE FINANCIAL CONGLOMERATES THAT CAN ATTRACT NEW FUNDS BY QUICKLY ADJUSTING SAVINGS RATES OR REACH OUT FOR DEPOSITORS THROUGH NATIONWIDE ADVERTISING AND DIRECT MAIL CAMPAIGNS. THE LIST OF CHALLENGES COULD GO ON AND ON.

ONE VITAL CREDIT UNION HEDGE AGAINST THE UNKNOWN IS THE NATIONAL CREDIT UNION SHARE INSURANCE FUND (NCUSIF). THE NCUSIF IS UNDERFUNDED, IN BOTH RELATIVE AND ABSOLUTE TERMS. UNLIKE THE OTHER FUNDS WHICH PROTECT DEPOSITORS--THE FEDERAL DEPOSIT INSURANCE CORPORATION AND THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION--THE NCUSIF WAS BEGUN 12 YEARS AGO WITHOUT ANY

CAPITAL INFUSION FROM THE FEDERAL GOVERNMENT. THE BANK AND SAVINGS AND LOAN INSURANCE FUNDS WERE CREATED IN THE 1930s AND CAPITALIZED WITH GOVERNMENT SEED MONEY.

AT PRESENT, THE RATIO OF DOLLARS IN THE CREDIT UNION FUND TO INSURED SHARES IS ONLY 3/10THS OF 1%--A LEVEL THAT HAS REMAINED FAIRLY CONSTANT FOR THE LAST SEVERAL YEARS. ALTHOUGH THE DOLLARS IN THE FUND HAVE ZOOMED FROM LESS THAT $88.9 MILLION IN FISCAL 1977 TO MORE THAN $235 MILLION IN FISCAL 1983, THIS GROWTH HASN'T BEEN FAST ENOUGH TO KEEP PACE WITH INSURED SHARES. SINCE IT IS THIS RATIO (FUND ASSETS AS A PERCENTAGE OF INSURED SHARES) THAT COUNTS IN DETERMINING THE STRENGTH OF THE FUND AS A SAFETY NET, THE CREDIT UNION FUND ISN'T UP TO PAR. IT IS BELIEVED THAT A MINIMUM OF 1% CAPITAL IS NEEDED.

S.2121 PROVIDES FOR A 1% DEPOSIT TO BE PLACED IN THE SHARE INSURANCE FUND BY ALL INSURED CREDIT UNIONS. IT ALSO GRANTS NCUA DISCRETION TO PHASE IN THE DEPOSIT OBLIGATION OVER A NUMBER OF YEARS. UTAH CREDIT UNIONS BELIEVE THAT A PHASE IN IS ESSENTIAL AND WILL STRONGLY URGE NCUA TO ADOPT THIS POLICY IF S.2121 IS ADOPTED. BECAUSE CREDIT UNIONS NOW HAVE SUBSTANTIAL LIQUIDITY, THE FUNDING OF NCUSIF SHOULD BEGIN NOW.

TAX EXEMPT STATUS OF STATE SHARE INSURANCE FUNDS

STATE SHARE INSURANCE FUNDS NOW FACE A PROBLEM WHICH IS NOT A PART OF THE LEGISLATIVE PROPOSALS BUT IS RELATED TO

SHARE INSURANCE. THIS PROBLEM IS THE IRS REVOCATION OF TAX EXEMPT STATUS FOR STATE SHARE INSURANCE FUNDS INCLUDING THE UTAH CREDIT UNION GUARANTY CORPORATION.

IN NOVEMBER OF LAST YEAR, THE IRS RULED (RULING 83-166) THAT CREDIT UNION SHARE INSURANCE FUNDS COULD NO LONGER BE TAX EXEMPT. THE BASIS FOR THE RULING WAS A 1957 RULING THAT GRANDFATHERED IN EXISTING FUNDS AND DECLARED FUNDS ESTABLISHED AFTER THAT YEAR WOULD BE TAXED. THE FUND THAT INSURES THRIFTS IN MARYLAND CHALLENGED THE IRS IN COURT AND LOST THEIR APPEAL FOR TAX EXEMPT STATUS IN THE SUPREME COURT IN OCTOBER OF 1970.

YET, BETWEEN 1961 AND 1981 THE IRS RULED THAT ALL OF THE FUNDS BUT TWO CREATED DURING THE PERIOD WERE EXEMPT AS BUSINESS LEAGUES UNDER SECTION 501(c)(6) OF THE CODE. THE REMAINING TWO ARE EXEMPT UNDER DIFFERENT STATUTES. EACH EXEMPTION WAS GRANTED ON A CASE-BY-CASE BASIS.

WE ARE CONCERNED ABOUT THE IMPACT THAT THE IRS' RULING MAY HAVE ON THE OPERATIONS OF THE SHARE INSURANCE FUNDS NOW THAT THEY ARE REQUIRED TO REORGANIZE AS TAXABLE ORGANIZATIONS.

CURRENTLY, THERE ARE 17 STATE INSURANCE FUNDS OPERATING IN 21 STATES. THEY INSURE OVER 3,000 STATE-CHARTERED CREDIT UNIONS, PROTECTING $13.8 BILLION NATIONWIDE. IN UTAH, INSURANCE COVERAGE IS GENERALLY AVAILABLE FOR AN UNLIMITED

AMOUNT ON EACH ACCOUNT. THE UTAH CREDIT UNION GUARANTY CORPORATION INSURES 170 CREDIT UNIONS WITH TOTAL ASSETS OF IN EXCESS OF $400 MILLION.

IN SOME STATES, THE INSURANCE FUNDS COVER THE MAJORITY OF CREDIT UNION DEPOSITS. IN WISCONSIN, FOR EXAMPLE, ALL BUT TWO FOR THE STATE'S 582 CREDIT UNIONS ARE COVERED BY THE STATE INSURER. IN TENNESSEE, 297 CREDIT UNIONS ARE BACKED BY THE STATE INSURANCE FUND, AND IN OHIO, 277 OF THE STATE'S 909 CREDIT UNIONS ARE PROTECTED BY THE STATE INSURER.

WE CONSIDER IT UNFAIR FOR THE IRS TO ELIMINATE THE TAX-EXEMPT STATUS OF THESE ORGANIZATIONS AFTER HAVING GRANTED IT TO THEM WHEN THEY ORGANIZED. IT IS OUR BELIEF THAT THE POLICY SET OUT IN REV. RUL. 53-166 SHOULD APPLY ONLY TO STATE INSURANCE FUNDS ORGANIZED AFTER NOVEMBER 7, 1983--THE DATE ON WHICH THE IRS ISSUED ITS RULING.

WE UNDERSTAND THAT THIS COMMITTEE DOES NOT HAVE JURISDICTION IN THIS MATTER. HOWEVER, WE WOULD APPRECIATE ANY ASSISTANCE YOU COULD PROVIDE IN HELPING US RESOLVE THIS MATTER IN A FAIR AND EQUITABLE WAY.

CONCLUSION

UTAH CREDIT UNIONS WELCOME THE COMMITTEE TO UTAH AND APPRECIATE THE OPPORTUNITY TO APPEAR AT THESE HEARINGS. IT IS OUR HOPE THAT THIS COMMITTEE'S TRACK RECORD IN THE 98TH CONGRESS IS AS PRODUCTIVE AS IT WAS IN THE 97TH. WE ENCOURAGE THIS COMMITTEE IN ITS WORK AND LOOK FORWARD TO ASSISTING YOU IN WHATEVER WAY POSSIBLE IN THE LEGISLATIVE PROCESS TO COME.

The **Chairman**. Thank you very much.

Before I turn to Mr. Beckstead, Jerry Christensen has asked me to make a correction in his testimony. In his opening paragraph he represented 13 members with combined assets of $20 billion. It's $2 billion. I wish it were $20 billion.

Senator **Lautenberg**. I was wondering about that.

The **Chairman**. I'm sorry. It was a typo. I wish it was the $20 billion, but the record will be corrected.

Senator **Lautenberg**. I thought he had really taken over the commercial banks and everything else.

The **Chairman**. Mr. Robert Beckstead.

STATEMENT OF ROBERT B. BECKSTEAD, PRESIDENT, COPPER STATE THRIFT & LOAN CO.

Mr. **Beckstead**. My name is Robert B. Beckstead. I am president of Copper State Thrift and Loan Co. located in Salt Lake City. I am also chairman of the Board of the Utah Consumer Finance Association and president of the Utah Industrial Loan Guaranty Corp., a State-chartered, nonprofit guaranty fund covering deposits in industrial loan corporations.

Before getting to my views on the proposed legislation, I would like to briefly describe my business and the role that industrial loan corporations have played in the State of Utah. I believe that this will help you understand my point of view.

Copper State Thrift & Loan Co. was organized in 1977. We have assets of approximately $22 million. We have traditionally emphasized consumer lending, but in recent years have been placing more emphasis on small business loan and leasing. To give you an idea of the niche that we fill, my average lease—generally to small businesses—is probably about $10,000. Our average is somewhat larger.

Utah is essentially a small business economy and the consumer and small business lending activities of industrial loan corporations have provided a service that banks and savings and loan associations have traditionally been unable or unwilling to provide.

For over 50 years, industrial loan corporations have been an important part of the financial community in the State of Utah. They have been a fourth category of financial institutions, with banks, savings and loans, and credit unions being the other three. They are empowered by the State to accept deposits and are closely supervised by the State Department of Financial Institutions. Deposits are guaranteed up to $15,000 by the Industrial Loan Guaranty Corp. Industrial loan companies in the State of Utah presently hold over $500 million in deposits.

REGULATIONS ARE MORE RESTRICTIVE THAN TO BANKS AND S&L'S

Industrial loan corporations are relied upon by the people of this State and are regulated to assure their safety and soundness by the Commissioner of Financial Institutions. Some of the regulations to which we are subjected are more restrictive than those which apply to banks and savings and loans. Some examples of this include a total statutory prohibition on loans to industrial loan corporations, employers, officers and directors, limits on the accrual of interest on delinquent loans and important restrictions on investments, particularly in real estate. The SEC and other Federal bodies have recognized that the State regulation that applies to industrial loan corporations are comparable to that which applies to banks. Industrial loan corporations, like other depository institutions, are eligible to participate in automated clearinghouses and in the direct desposit program of U.S. Treasury checks. Industrial loan corporations are also made eligible for the small savers tax exemption program under the Internal Revenue Code and most recently their eligibility for Federal Deposit Insurance was confirmed by the Garn-St Germain Depository Institutions Act of 1982.

We are very anxious that legislation intended to deal with the relatively new category of institutions known as "nonbank banks" not jeopardize our business or limit our ability to fairly compete with other financial institutions. We are not afraid of competition and we especially appreciate the steps that Congress, and your committee, Senator Garn, in particular, have taken to let financial institutions compete.

It seems clear to us that such competition will have the effect of lowering the cost and improving financial services provided to members of the public, limiting potential conflicts of interest and reducing concentration of power and resources. The question before this Congress is whether to encourage further evolutionary changes in financial markets or stifle them by attempting to turn back the clock.

IMPACT OF S. 2181 ON CONSUMER BANKS

We appreciate the recognition of S. 2181 of consumer banks, which is essentially what industrial loan corporations have been in the past. However, we are concerned that the strictures placed on them in the bill, coupled with efforts which are presently being made by the Federal Reserve Board, will unrealistically limit their activities and preclude them from playing a vital role in the future evolution of the financial institutions and markets.

We have functioned very well under State chartering and regulation and are at a loss to understand what reason there is to preempt this by increasingly severe Federal restrictions. For instance, we know of no particular regulatory problems that need to be addressed by subjecting companies such as mine, conducting business as permitted by State law, to the Bank Holding Company Act. Nevertheless, the Federal Reserve Board has defined the terms "demand deposits" and "commercial loans" in decisions and in a recent revision of regulation Y in such a way that, if I conduct business as I have been authorized to do by my State regulator, my industrial loan corporation will become a bank and its parent will become a bank holding company.

While S. 2181 is clearly a step in the right direction and is far preferable to other legislative proposals that have been advanced, we don't feel that it goes far enough. The bill exempts "consumer banks" from regulation under the Bank Holding Company Act, but it circumscribes the activities of such institutions in ways that will preclude them from providing the kinds of services that they have provided in the past. Some examples might be helpful:

First, S. 2181 limits the ability of consumer banks to make commercial loans to 5 percent of the institutions' total assets. This is especially troublesome to us because the Federal Reserve Board has greatly enlarged the definition of "commercial loans"—they now include such things as the purchase of commercial paper, certificates of deposit, and money market instruments. Industrial loan corporations frequently invest their idle funds in such instruments. And, a 5-percent limitation on commercial loans will greatly restrict us in continuing to serve our small business customers. Many of the large commercial banks are not interested in providing the kinds of services that these small businesses need. And, if we are unable to serve their needs, we wonder who will.

Second, the bill does not address the Federal Reserve Board's expansive definition of the term "demand deposits." It has ignored the plain wording of the definition in the Bank Holding Company Act and has attempted to classify NOW accounts as demand deposits, even though persons having such accounts do not have a legal right to make withdrawals from them on demand.

Third, it provides that any institution eligible for FDIC insurance is a bank. As mentioned earlier, industrial loan corporations were specifically made eligible for FDIC insurance by the Garn-St Germain Depository Act. One industrial loan corporation, as Mr. Higgins mentioned, operating in the State of Utah has already been approved for FDIC coverage.

One possible justification for attempting to bring transaction-type accounts of industrial loan corporations or consumer banks under bank-type controls is that this is needed in connection with the control of monetary policy. However, such control already exists. In the Monetary Control Act of 1980, Congress subjected NOW accounts, including those accepted by industrial loan corporations, to the same reserve requirements which apply to demand deposits accepted by banks.

Thus, the issue here is not monetary policy, but is one of whether there is a need to regulate the ownership and operations of industrial loan corporations for safety and soundness reasons. As stated previously, we feel that the industrial loan corporations in Utah are being ably supervised by our State department of financial institutions. You have heard from our regulator, Commissioner Weis, today. We feel, as she does, that without strong public policy reasons for doing so, there is no real justification for fundamentally altering the regulatory framework for a class of financial institutions that is filling an important public need and has been operating successfully under State regulation for over 50 years.

At a time when deregulation is being stressed, why impose on a category of financial institutions Federal restrictions which will inevitably require divestitures, dislocation, and interruption of established customer relationships? Depositors in industrial loan corporations are presently well protected. The kinds of changes being sought by the Federal Reserve Board and to some extent included in this bill will clearly restrict competition and hurt rather than help customers that we have served for many years.

While we agree with the basic thrust of S. 2181 and appreciate its recognition of consumer banks as a special category of financial institutions, we are anxious that such institutions will be so limited in their activities that they will not be able to fairly compete in the changing economic and regulatory environment. Some very minor changes in the definitions in S. 2181 would permit us to continue to serve the customers that we are now serving, and provide the kind of services that they need. We have responsibly done so in the past and believe that we can do so in the future. We would welcome the chance to suggest some minor changes to the committee and its staff that would accomplish this result.

On behalf of our association, I appreciate the opportunity we have had to testify. Thank you very much.

[The complete statement follows:]

STATEMENT OF

ROBERT B. BECKSTEAD

PRESIDENT

COPPER STATE THRIFT AND LOAN COMPANY

My name is Robert B. Beckstead. I am President of Copper State Thrift and Loan Company located in Salt Lake City. I am also Chairman of the Board of the Utah Consumer Finance Association and President of the Utah Industrial Loan Guaranty Corporation, a state-chartered, non-profit guaranty fund covering deposits in industrial loan corporations.

Before getting to my views on the proposed legislation, I would like to briefly describe my business and the role that industrial loan corporations have played in the State of Utah. I believe that this will help you understand my point of view.

Copper State Thrift and Loan Company was organized in 1977 with total capital and assets of $275,000. Today the company has assets of $22,000,000. We have traditionally emphasized consumer lending, but in recent years have been placing more emphasis on small business lending and leasing. To give you an idea of the niche that we fill, my average lease (generally to small businesses) is probably about $10,000. Commercial banks are generally not interested in leases of this size.

Utah is essentially a small business economy and the consumer and small business lending activities of industrial loan corporations have provided a service that banks and savings and loan associations have traditionally been unable or unwilling to provide.

For many years industrial loan corporations have been an important part of the financial community in the State of Utah. They have been a fourth category of financial institutions, with banks, savings and loans and credit unions being the other three. They are empowered by State law to accept deposits and are closely supervised by the State Department of Financial Institutions. Deposits are guaranteed up to $15,000 by the Industrial Loan Guaranty Corporation. Industrial loan companies in the State of Utah presently hold over $500,000,000 in deposits.

Industrial loan corporations are relied upon by the people of this State and are regulated to assure their safety and soundness by the Commissioner of Financial Institutions. Some of the regulations to which we are subjected are more restrictive than those which apply to banks and savings and loans. Some examples of this include a total statutory prohibition on loans to industrial loan corporation officers and directors, limits on the accrual of interest on delinquent loans and important retrictions on investments. The SEC and other federal bodies have recognized that the state regulation that applies to industrial loan corporations is comparable to that which applies to banks. Industrial loan corporations, like other depository institutions, are eligible to participate in automated clearing houses and in the direct deposit program of U.S. Treasury checks. Industrial loan corporations were also made eligible for the small savers tax exemption program under the Internal Revenue Code and most recently their eligibility for Federal Deposit Insurance was confirmed by the Garn - St Germain Depository Institutions Act of 1982.

We are very anxious that legislation intended to deal with the relatively new category of institutions known as "non-bank banks" not jeopardize our business or limit our ability to fairly compete with other financial institutions. We are not afraid of competition and we especially appreciate the steps that Congress, and your Committee in particular, have taken to let financial institutions compete.

It seems clear to us that such competition will have the effect of lowering the cost and improving financial services provided to members of the public, limiting potential conflicts of interest and reducing concentrations of power and resources. The question before this Congress is whether to encourage further evolutionary changes in financial markets or stifle them by attempting to turn back the clock.

We appreciate the recognition in S.2181 of "consumer banks", which is essentially what industrial loan corporations have been in the past. However, we are concerned that the strictures placed on them in the bill, coupled with efforts which are presently being made by the Federal Reserve Board, will unrealistically limit their activities and preclude them from playing a vital role in the future evolution of financial institutions and markets.

We have functioned very well under State chartering and regulation and are at a loss to understand what reason there is to preempt this by increasingly severe Federal restrictions. For instance, we know of no particular regulatory problems that need to be addressed by subjecting companies such as mine, conducting business as permitted by State law, to the Bank Holding Company Act. Nevertheless, the Federal Reserve Board has defined the terms "demand deposits" and "commercial loans" in decisions and in a recent revision of Regulation Y in such a way that, if I conduct business as I have been authorized to do by my State Regulator, my industrial loan corporation will become a bank and its parent will become a bank holding company.

While S.2181 is clearly a step in the right direction and is far preferable to other legislative proposals that have been advanced, we don't feel that it goes far enough. The Bill exempts "consumer banks" from regulation under the Bank Holding Company Act, but it circumscribes the activities of such institutions in ways that will preclude them from providing the kinds of services that they have provided in the past. Some examples might be helpful:

First, S.2181 limits the ability of "consumer banks" to make commercial loans to 5% of the institutions' total assets. This is especially troublesome to us because the Federal Reserve Board has greatly enlarged the definition of "commercial loans" - they now include such things as the purchase of commercial paper, certificates of deposit and money market instruments. Industrial loan corporations frequently invest their idle funds in such instruments. And, a 5% limitation on commercial loans will greatly restrict us in continuing to serve our small business customers. Many of the large commercial banks are not interested in providing the kinds of services that these small businesses need. And, if we are unable to serve their needs, we wonder who will.

Second, the Bill does not address the Federal Reserve Board's expansive definition of the term "demand deposits". It has ignored the plain wording of the definition in the Bank Holding Company Act and has attempted to classify NOW accounts as demand deposits, even though persons having such accounts do not have a legal right to make withdrawls from them on demand.

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Thus, the issue here is not monetary policy, but is one of whether there is a need to regulate the ownership and operations of industrial loan corporations for safety and soundness reasons. As stated previously, we feel that industrial loan corporations in Utah are being ably supervised by our State Department of Financial Institutions. You have heard from our regulator, Commissioner Elaine Weis, today. We feel as she does, that without strong public policy reasons for doing so, there is no real justification for fundamentally altering the regulatory framework for a class of financial institutions that is filling an important public need and has been operating successfully under State regulation for thirty years. At a time when deregulation is being stressed, why impose on a category of financial institutions Federal restrictions which will inevitably require divestitures, dislocation and interruption of established customer relationships? Depositors in industrial loan corporations are presently well protected. The kinds of changes being sought by the Federal Reserve Board and to some extent included in this Bill will clearly restrict competition and hurt rather than help customers that we have served for many years.

While we agree with the basic thrust of S.2181 and appreciate its recognition of "consumer banks" as a special catetory of financial institutions, we are anxious that such institutions not be so limited in their activities that they will not be able to fairly compete in the changing economic and regulatory environment. Some very minor changes in the definitions in S.2181 would permit us to continue to serve the customers that we are now serving, and provide the kind of services that they need. We have responsibly done so in the past and believe that we can do so in the future. We would welcome the chance to suggest some minor changes to the Committee and its staff that would accomplish this result.

I sincerely appreciate the scheduling of these hearings in Salt Lake City and the chance to express my views on these matters which are so vital to my company's future and to the other thirty-six industrial loan corporations operating in the State of Utah.

The CHAIRMAN. Thank you very much.

Gentlemen, in the interest of time with such a large panel, I will reserve my questions and submit to you in writing any not answered by your written statements, and Senator Lautenberg has one or two he would like to ask now.

FIXED RATE VERSUS VARIABLE RATE MORTGAGE LOANS

Senator LAUTENBERG. Mr. Christensen, you said in your statement about the volume of mortgage loans generally being made available in the growth of those loans. Do you have, offhand, the percentage of those that are fixed-rate long-term loans versus variable mortgage loans that are being offered in say the last year?

Mr. CHRISTENSEN. You mean in terms of the interest rates, the differential?

Senator LAUTENBERG. The different character of the two type loans; one fixed-rate loan opposed to variables of whatever character.

Mr. CHRISTENSEN. Well, currently first mortgage 30-year term is around 13 percent. A variable or adjustable rate loan——

Senator LAUTENBERG. Percentage of the total loan or total volume.

Mr. CHRISTENSEN. In our case about 83 percent of our loans are on a variable or adjustable rate loan. Most of the consumers or borrowers coming in, even though they are applying for a fixed-rate loan, would see the difference and because of the adjustment in the interest rate and the caps and protections put on it, would then select the adjustable rate.

Senator LAUTENBERG. You haven't had it out long enough, have you, for people to have gone through—well, what's typical; 5-year, or 30-year, or 25-year payoff schedule or adjustable at 2-year intervals with a balloon at the end?

Mr. **Christensen**. It's a new product. There are several variations. There's a 15-year plan, a 25-year plan with a balloon. There's annual adjustments and I think the marketplace is just finding what is acceptable and what is acceptable in the secondary market.

Senator **Lautenberg**. I notice that your statement was fairly confident about your ability to handle the demand for mortgages. But I think that footnote, and again I am not trying to push this back into the Stone Age or even to the fixed mortgage, but the fact that your volume has gone up considerably really doesn't tell the whole story because the conditions to the borrower have changed considerably. I wondered how good people feel about that when time is up and they have to recast those things or the interest rates turn from the direction they are now down.

Mr. **Christensen**. Well, there's no perfect adjustable rate mortgage where you can pass all the risk on to the borrower. That's impossible. But there's got to be some kind of ground in this deregulation process that wouldn't totally deregulate the liability side. The assets we put on must have some adjustable characteristic to it.

Senator **Lautenberg**. I wouldn't ask your industry or anybody else to lend fixed rates. I mean the experience you are talking about has been disastrous. Many of the companies that have been operating for years in what seemed to be tougher times couldn't handle it. We don't want to see that again. But I am trying to get an idea in terms of the responsibility for the various parts of the financial industry; who takes what? One part is being asked to take a potential part in residential loans and the other part isn't and I would like to equalize that.

ENCOURAGE PAYMENT-ON-DEMAND DEPOSITS

I wanted to ask Mr. Higgins a question and ask Mr. Hawkes to respond. That is, if I understand you, you didn't mind and as a matter of fact I think you encouraged payment on a demand deposit saying it should be phased in as opposed to coming in suddenly. Is that correct?

Mr. **Higgins**. Yes; that's correct.

Senator **Lautenberg**. Mr. Hawkes, you had a different view in your statement.

Mr. **Hawkes**. We have an opposition to the payment of interest. The reason being as near as we can determine it has a severe impact on our earnings.

Senator **Lautenberg**. I was in California and I talked to some of those mammoth organizations. I am continually flabbergasted by the size of the banking institutions out there. New Jersey is not doing badly. After the merger, it will be $11 billion and that's a pretty good-sized bank. But we are like some of their branch banks out there. The attitude I got, almost universally, is they would rather forego the interest on the reserves as opposed to paying the interest on the transactions on the demand deposits. The cost of servicing it is going to be very heavy. But you feel confident it's a good piece of business?

Mr. HIGGINS. Senator, we feel that regardless of our opposition, it is coming. We can see now in the form of different types of things that banks have to do to pay interest on demand deposits through repurchase agreements, for example. Some of the banks in Salt Lake are instituting what they call zero balance accounts. They allow a corporation or a company to keep their money in an account that is interest bearing and as the checks and transactions hit their checking account funds are then transferred from that interest-bearing account into their checking account, which is a perfectly legal maneuver. But it's a very expensive one.

I don't know the percentage. I could throw up a figure and say that about half the companies doing business now through some means are in effect getting interest on their demand deposits.

I know our customers come in to us and say, "I've been up the street. I have a time certificate that I don't need the money on for a few days. They will pay me 9¼ percent. What will you pay me?" They jockey one aginst the other even though they are our good customers. They have their checking account with us. But that money doesn't stay in checking. It stays in a CD somewhere or a repo somewhere and then moves to that checking account when it is needed.

So we think that, and certainly in the Utah Bankers Association it is not unanimous, that everyone feels that interest on checking accounts is inevitable and therefore should be allowed. I believe we feel almost unanimously that it is coming sooner or later.

Senator LAUTENBERG. I'd be curious about how your members feel about it. Thank you very much, Mr. Chairman.

The CHAIRMAN. I'd like to make a couple of comments before we close this particular panel.

I think the key issue is demand deposits. I try living in the real world and what is taking place, and it is here. With NOW's, super NOW's, and repo's and all of the things you are doing, it is fine. I understand your opposition. I understand the cost of all that. But it is very much like a lot of people who testified in favor of removing interest rate ceiling and then came back after the fact and said, "Good heavens. We wish we hadn't done that. It's increased the cost of money."

And I said, "Compared to the legal shenanigans you are going through to stop the outflow of money going through your institutions to stop the complicated matters?"

And they said, "Well, I understand."

Whether you are for it or against it, it is here and it is coming. So why not make it legal? That's the way I view it. Why not make legal what is going on out there? You continue to fight windmills and say, "We don't like it." I understand.

Senator LAUTENBERG. There are other habits, Mr. Chairman, that are going on out there that we don't legalize.

The CHAIRMAN. I am talking about financial services. Let's not get away from the subject.

Gentlemen, thank you very much.

Before the next panel comes up, in the interest of everybody, we are going to take a 5-minute break.

[Whereupon, a 5-minute recess was taken.]

The **Chairman**. The committee will reconvene with the third panel: Mr. Lyle Davis, partner, Wilson Davis & Co., Salt Lake City; president, Utah Securities Association; accompanied by Kenneth Burbidge, vice president and resident manager, Dean Witter, Reynolds, Inc., Salt Lake City. And Harold W. Dance, president, Harold W. Dance Brokerage, Logan, Utah; president, Dance Insurance, Inc.; member, Institute of Certified Financial Planners; member, International Association of Financial Planners.

Gentlemen, we are happy to have each of you with us. Mr. Davis, if you'd like to begin.

Statement of Lyle W. Davis
Vice President
Wilson-Davis & Co.
Before the
Senate Committee on Banking, Housing, and Urban Affairs
January 16, 1984

Mr. Chairman:

I'm Lyle W. Davis. I am a vice president of Wilson-Davis & Co. I am also the president of the Utah Securities Dealers Association which consists of 17 locally owned firms which specialize in OTC Stocks. We are all small securities dealers who support the stocks of lesser-known companies. My own firm is a market maker in 44 NASDAQ stocks and 260 non-NASDAQ OTC stocks. The companies whose capital stocks we provide a market for are mostly located in the region of Utah, Nevada and California, with quite a few headquartered right here in Salt Lake City. I have been in the securities business myself for 15 years, all of them with Wilson-Davis.

In September of 1982 I was a participant in the Securities and Exchange Commission Government Business Forum on Small Business Capital Formation under the direction of Commissioner Evans of the SEC. I have served on numerous committees of the NASD. I also serve as a member of the Advisory Board for the Utah Securities Division of the Department of Business Regulation having been appointed to that board by Governor Matheson.

I am pleased to have this opportunity to address my concerns to this Committee about S. 2181. As you know better than I, Mr. Chairman, Washington is a long way from Salt Lake City.

Nonetheless, what you do there and what you propose to do there acutely affects our businesses and our lives.

We believe in our end of the business that we perform a very important service in supporting the firms we do. We are proud of our role in providing capital for these companies. But I am concerned about our future and the future of small companies which need capital if big banks enter and eventually dominate our business which is what I fear.

A few years ago the SEC did a study on what harmful effects there might be if banks were allowed to underwrite all municipal revenue bonds as they wished. They found that the numbers of small, regional firms which are active in the part of the securities business that we are in would shrink because of the business the banks would take away. Some small and regional firms would not be able to survive without that business and would shut down; others would be forced into mergers and acquisitions by bigger firms, all to the detriment of capital formation, particularly for emerging growth companies. And we should remember that most new jobs are created in new and smaller firms.

Bigger isn't necessarily better. Bigger firms often aren't in touch with or interested in the little guy and getting his capital raised. That's why we need smaller firms in the securities business. Our industry has plenty of big firms already without having big banks with their special powers in it, too. Personally, my firm does not engage in the revenue bond business, so that bank underwriting is not a direct threat to me, but I know that it certainly is for many smaller firms throughout the country. But that threat affects other areas of our business as well. If the banks are allowed to skim off mutual funds and other pieces of the securities business, it will be more difficult for us smaller firms to survive and prosper handling what is left.

Turning to the bill, Mr. Chairman, I have been reading over the kinds of securities activities that it would permit banks through their holding companies to get into. Frankly, I am staggered.

The first new activity proposed is underwriting of municipal revenue bonds. Since we don't underwrite municipal revenue bonds I don't know a great deal about that area. I do know that for years the big banks used to claim huge savings for issuers if they could only underwrite revenue bonds. I gather they have largely stopped saying that after their supposedly definitive study fell apart in hearings before the House Banking Committee in 1979. Now they just say it's a good thing, more competition. If banks can enter any field to compete with non-banks with all or even many of their special advantages of federally insured deposits, lower taxes, lower cost of capital, special deductions, access to the federal money window, there won't be greater competition, there will be less. How many of us would be left after ten years?

Not only is there no evidence of any positive benefit from banks being able to underwrite revenue bonds, there is the grave possibility of some real harm. Since 1968 banks have been able to underwrite housing revenue bonds but never achieved much success until recently. Why did their business improve? When interest rates got high securities firms structured deals with letters of credit to help bring down interest rates on bonds. Suddenly banks began appearing in management groups. How come? One study done by the Securities Industry Association and filed with your Committee showed that in every single negotiated housing bond issue involving a letter of credit supplied by three major banks in 1981 the bank was in the underwriting management group - 24 times out of 24 times. None of the three banks was a manager in a housing bond issue that year where it did not offer a credit facility. So how did the banks achieve their sudden success? Sounds like a tie-in to me.

Now my firm does not do much in the way of a mutual fund business either. S. 2181 proposes that banks through their affiliates be allowed to underwrite, advise and manage mutual funds. Originally, banks wanted to get into mutual funds when money market funds became popular in the late '70s and early '80s. They cried unfair competition. They claimed that the yields on money market funds were really the same as interest on bank accounts and that any difference was only technical and, therefore, banks should have the right to operate money market mutual funds. The securities industry rightly pointed out that the answer wasn't giving mutual fund powers to banks but deregulating interest rates. That was done. Now banks have their own federally insured market interest rate deposit accounts, which is money a bank can use in its business. They now have a tremendous advantage over a money market mutual fund offered by the mutual fund industry. So what is the reason for still suggesting that banks underwrite and deal in mutual funds?

Whatever validity there may have been to the argument comparing the yield of money market funds to interest on deposits, no such comparison can be made between interest on deposits and dividends received from other kinds of mutual funds. They are pools of stocks and bonds in large measure. There is a market risk involved for an investor who owns shares. Mutual funds are an integral part of the securities business and dealing in their shares is as close to dealing in common stock as can be.

Your bill also would permit banks to underwrite and deal in mortgage-backed or mortgage-related securities. This is something relatively new. It isn't a government security or a general obligation municipal bond. A mortgage-backed security represents an interest in a pool of mortgages and is an instrument tailored to sell in the capital markets much like a corporate bond.

I could at least understand the argument that revenue bonds were just like general obligation municipal bonds and that only a small extension of authority was involved in giving banks the power to underwrite those bonds, although I didn't agree with the argument. I could also understand the argument that yield on money market mutual funds was the same as interest on deposits as a practical matter and that something should be done; deregulating interest rates on special accounts was the right solution to that problem. However, I see absolutely no basis for any argument that banks should be able to deal in mutual fund shares or in mortgage-backed securities. That is striking at the very heart of Glass-Steagall and the separation of the speculative nature of investment banking from the responsibilities of commercial banks. That separation was a key, integral factor, along with federal insurance of deposits, in the creation of the safe, sound and secure banking system that we trace back to 1933.

The Glass-Steagall Act's separation of commercial and investment banking has made a major contribution to the depth and diversity of the financial marketplace in the United States. It has allowed the side-by-side development of different financial services industries which today offer unequaled credit and capital alternatives benefitting consumers, businesses and state and local governments. It has prevented commercial banks with their special advantages from using those advantages to crowd out and eliminate other providers of financial services who lack those advantages. The Glass-Steagall Act has contributed to the building of confidence in a sound banking system, stimulated competitiveness, helped avoid undue concentrations of economic power and inspired innovativeness in both commercial and investment banking. With such a record, why tear it down?

What about those problems of the '20s and '30s? What about those matters of conflict of interests; what about those tie-ins? What abouth the health of the securities industry and the continued health and existence of small securities firms? If I remember my history correctly, most of the banks which got into stock market trouble in the '20s and '30s didn't do so directly, but through securities affiliates such as are proposed here. Under this arrangement, if a securities affiliate got into trouble, where would the capital come from to bail it out? Would a bank through its holding company just let it go or would it chase after it as happened when troubles hit the real estate investment trusts? Would the deposits of people be protected? Would federal insurance wind up, for example, protecting a bank securities affiliate dealing in mortgage-backed securities? Can you really protect the bank completely by way of an affiliate? Can you really eliminate a bank's special advantages and ability to tie services to its credit power? I for one doubt it very much.

Mr. Chairman, this bill is terribly sweeping and would make massive changes in the way financial business is done in the United States Today. In the securities area, what the bill would allow banks to do, and I believe it would be mostly big banks who would do these things, is just about everything this side of corporate stocks. If your proposal were to pass, with revenue bonds, mutual funds and mortgage-backed securities in it, the pressure to let the banks all the way back into the securities business would become irresistible.

I oppose the basic premise of S. 2121. I view it as a big bank bill and I do not see how it helps the capital markets or the presently thriving OTC capital formation work that my firm and others are doing or the soundness of the banking system. Even in permitted securities activities banks can get caught in speculative situations and incur huge losses. Our firm has good banking relations and we borrow from our bank often. If the bank becomes our competitor this present relationship could be jeopardized. Where would I then go to borrow needed funds?

I respectfully urge you and Congress to investigate ways to make the Glass-Steagall Act work better, and not to tear it down. I appreciate your taking the time to investigate how the capital markets are functioning. Nothing should be done to jeopardize their health. "If it ain't broke, don't fix it" seems to fit the current state of affairs. In the context of a full scrutiny of the Glass-Steagall Act and the securities laws relating to bank securities activities, the public can judge whether the Act should be eliminated altogether, weakened, preserved intact, strengthened or otherwise amended. The gains and the losses which would flow from any proposed changes must be carefully weighed. Such a review is an essential prerequisite to major legislative changes, in my opinion. If freeze or moratorium is needed to privide the necessary time, then that should be put in place first.

Mr. Chairman, as you may have gathered, I am overwhelmed by the scope of this proposal for expansion of the powers of the banking industry. I fervently hope that Congress will continue taking time necessary to consider carefully the consequences before moving to enact changes of such magnitude.

Thank you.

The Chairman. Thank you, Mr. Davis.

Mr. Burbidge.

STATEMENT OF KENNETH P. BURBIDGE, JR., FIRST VICE PRESIDENT AND GENERAL MANAGER, DEAN WITTER REYNOLDS, INC.

Mr. Burbidge. I'd like to announce that the text of my remarks has been changed somewhat from what you have in front of you. A copy has been given to Ms. Kent.

Mr. Chairman, My name is Kenneth P. Burbidge, Jr., first vice president and resident manager for Dean Witter Reynolds, Inc., in Salt Lake City. I have been in the securities business for 28 years, and have been with Dean Witter for the past 10 years, all in Salt Lake City.

My earlier experience includes serving as an assistant manager for Schwabacher & Co., and as vice president and resident manager for Blyth & Co. for 13 years, all in Salt Lake City.

I appreciate the opportunity to appear before this committee and to express my views in a general way on the thrust of S. 2181, the Financial Services Competitive Equity Act.

As I understand the legislation, Mr. Chairman, It would permit banks and savings and loans through a holding company structure to pursue all types of insurance, deal in mutual funds, develop real estate, underwrite municipal revenue bonds, and underwrite and deal in mortgage-backed securities.

We all live with our banks. Some of my best friends are bankers. On the other hand, none of us for a moment is ignorant of the power and clout that a good-sized bank has. That has been discussed by Senator Lautenberg but I'd like to make it an important part of my testimony. That's the place where we go for our business loans and our personal loans. There is no question in my mind that if that bank is at the same time trying to sell me insurance, sell me a house, mutual fund, or mortgage-backed security, I'd better think twice before I say I'm going to buy those products somewhere else. Congress can write all the laws it wants about how tying one product or service to another is illegal and should not be done. But we all know the subtle pressures that are always there and can be exerted. That is a potential for unfair competition that just cannot go away. The best thing we can do is to prevent these possibilities from arising in the first place.

"BACKYARD" COMPETITION

There's something I'd like to call "backyard" competition. None of us scream or squirm very much until it affects us personally.

The Wall Street Journal in recent issues has pointed out in great depth that indeed the banking industry itself is concerned about the regional acquisitions of ailing savings and loans. Bankers and elected officials in each area presently threatened, Florida and Chicago, are quoted on Tuesday, January 10, and Thursday, January 12 as saying the State and cities financial system may be jeopardized through undue concentration of financial resources. Backyard competition. Once it is prevalent, we all squirm a bit. The Journal also reports on Thurday, January 12, that Federal Reserve Board

Chairman Paul Volcker, who spoke this morning, is circulating a white paper within the administration denouncing proposals to eliminate or scale back the Fed's authority which are implied by some asking for the sweeping regulatory changes in our financial system. People in this country are concerned about deregulation as is clearly pointed to in an article in Business Week, November 28, 1983:

> Financial deregulation is confronting some hard political realities. The steps taken so far, particularly the removal of ceilings on interest rates and the unfixing of brokerage commissions, have overcome the resistance of entrenched interest with the help of a strong argument favoring consumers. But there is no similar consumer constituency for this next step in financial deregulation: permitting banks and securities firms to get into each others' business more directly or permitting full interstate banking.

I happen to think what Congress did in the Glass-Steagall Act 50 years ago was a good thing for that time. Commercial banks had one area of business to concentrate on. They were given access to government moneys, a federally insured deposit system was developed for them and they were basically cut off from other businesses which were risky such as investment banking and securities.

NEED FOR FURTHER STUDY

Before the lines of regulation are broken, a serious study must produce conclusions that the public will enjoy the benefits. Let's not contemplate change which may only favor the economies of financial size.

I think it's better that we don't assume any conclusions at this point, because we do not all have a good understanding of where the financial marketplace of tomorrow should or will be. I do know this: we have capital-raising mechanisms in this country which are the best in the world. We have large, successful banks which do a good job. And let's not forget that we all benefit from a sound banking system. We have an efficient, highly competitive securities business. I certainly see plenty of real estate and insurance activity all around me, and, although I am no expert on these fields, I wonder why banks are needed in that area.

The inherent clout and power that banks have cannot be adequately legislated against. I have already mentioned tie-ins. I don't believe you can legislate effectively how a bank is going to deal with an affiliate which is in the securities business. Is that bank going to be able to lend to that securities affiliate? When money is tight, sometimes it isn't the cost of money that is most important, but whether money is available at all and for whom and when. There is just no way you can set any standard of fair dealing that can be properly policed.

We all have to sort this business out. The securities industry has said that it supports a moratorium and I think that makes a lot of sense. I know, Mr. Chairman, that you will tell me that a moratorium is just another excuse for Congress not to take any action and that Congress doesn't need any excuses to go slow or do nothing. However, from where I sit, I see no reason to set in motion a series of events when we don't know what we want or what will happen if these changes are made.

I think we in America ought to be pretty satisfied with the way the financial markets are working. Why should we legislate major changes at this particular point in time? I certainly know that Citibank and its cousins want to be everywhere and do everything, but I don't think that that's a reason for making changes such as this. A few years ago we all agreed that what was good for General Motors wasn't necessarily good for America. I feel the same way about major city center banks. What's good for Citibank may not be good for the rest of us. Their newspaper ads say "The Citi never sleeps." Boy, do I believe that.

There is tremendous competition within the securities business right now and it is every bit as competitive as it was 20 years ago. Anybody can enter the business except for banks. That's a pretty wide field of choice. What I think will happen if banks can get into this business is that they will in the not too distant future tend to strangle competition with their inherent clout.

With nearly 14,000 commercial banks in the country now, how many will be around under deregulation at the turn of the century? We are reminded that 150 banks in the United States control less than one-half of all bank deposits while in Europe, Germany, France, Great Britain, and Switzerland 4 or fewer banks have this control. Do they operate more effectively for the consumer? A good question.

I'm for a further study period. I'd like Congress to blow the whistle and get on with figuring out what's better. Not better for Citibank or Dean Witter, but better for America. How Congress tackles the problem, whether each banking committee should develop its own studies and reports, whether a commission should be established of people from the industries involved, I leave to Congress. But before we jump out the window into the brave new world we should have a better idea of what the lay of the land is beneath us.

Thank you, Mr. Chairman. I certainly am ready to answer any of your questions.

[Complete statement follows:]

Statement of Kenneth P. Burbidge, Jr.
First Vice President and General Manager
Dean Witter Reynolds, Inc.
Before the
Senate Committee on Banking, Housing, and Urban Affairs
January 16, 1984

Mr. Chairman [and members of the Committee]:

My name is Kenneth P. Burbidge, Jr. first vice president and general manager for Dean Witter in Salt Lake City. I have been in the securties business for 28 years, and have been with Dean Witter for the past 10 years.

My earlier experience includes serving as an assistant manager for Schwabacher and as a partner in Blyth and Company for 13 years. I have also been active in the Utah Securities Dealers Association and the District 3 NASD Committee.

I appreciate the opportunity to appear before this Committee and to express my views in a general way on the thrust of Senate 2181, the "Financial Services Competitive Equity Act."

As I understand the legislation, Mr. Chairman, it would permit banks and savings and loans through a holding company structure to do all kinds of insurance, deal in mutual funds, develop real estate, underwrite municipal revenue bonds and underwrite and deal in mortgage-backed securities. Mr. Chairman, with all due respect, that's not a bank, that's an octupus.

We all live with our banks. Some of my best friends are bankers. On the other hand, none of us for a moment is ignorant of the power and clout that a good-sized bank has. That's the place where we go for our business loans and our personal loans. There is no question in my mind that if that bank is at the same time trying to sell me insurance, sell me a house, mutual fund or mortgage-backed security, I'd better think twice before I say I'm going to buy those somewhere else. Congress can write all the laws it wants about how tying one product or service to another is illegal and should not be done. And I don't know many bankers who will admit that it takes place. But we all know the subtle pressures that are always there. That is unfair competition that just cannot go away. The best thing we can do is to prevent these possibilites from arising in the first place.

I was astonished to read in one of my favorite newspapers the other day, The Boston Globe, the issue of January 8, 1984, this statement by an officer of a large Boston bank:

> I just absolutely refuse to lend to any cities and towns that don't keep balances with us.

When questioned as to whether or not that wasn't blackmail, the banker replied:

> Is it blackmail if you or I go into a bank for a mortgage and they say, 'Do you have an account with us'? Banks have been doing that for years. It's called doing business.

I'm afraid that I am one of those people who do in fact believe the candid statement of the Boston banker that that is indeed "doing business" and that's one of the things I'm concerned about. In my view, the whole idea of giving banks, with all their ultimate credit power, the right to invade other businesses is just wrong. If banks think the grocery business is profitable, no doubt they'll want to get into that, too.

I happen to think what Congress did in the Glass-Steagall Act 50 years ago was a good thing. Commercial banks had one area of business to concentrate on. They were given access to government monies, a federally insured deposit system was developed for them and they were basically cut off from other businesses which were risky such as investment banking and where their clout and special advantages - mostly created by the government - would make competition unfair.

We have a long history in America, going back much, much longer than 50 years, of separating banking and commerce and I think that that is a good thing too. Banks on one side, everybody else on the other. It is obviously difficult in any situation to draw a line. There are clever people at work all the time trying to figure out ways to cross the line or come as close as they can. That's human nature. And my company looks at the line as hard as any, I admit. But sometimes the line isn't drawn as well as it might have been. There appears to be no question, for example, that there is a loophole in the Glass-Steagall Act. These non-bank bank acquisitions that are going on are only possible because of that loophole. I understand, Mr. Chairman, that your bill would give that loophole special status and loophole banks would become "consumer banks." I am not at all sure that that is the way to go.

I think it better that we don't assume any conclusions at this point, because we do not all have a good understanding of where the financial marketplace of tomorrow should be. I do know this: we have capital-raising mechanisms in this country which are the best in the world. We have large, successful banks (except when they get into speculative ventures) which do a good job. And let's not forget that we all benefit from a sound banking system. We have an efficient, highly competitive securities business. I certainly see plenty of real estate and insurance activity around me, and, although I am no expert on those fields, I wonder why banks are needed there.

The inherent clout and power that banks have cannot be adequately legislated against. I have already mentioned tie-ins. I don't believe you can legislative effectively how a bank is going to deal with an affiliate which is in the securities business. Is that bank going to be able to lend to that securities affiliate? When money is tight, sometimes it isn't the cost of money that is most important, but whether money is available at all, for whom and when. There is just no way you can set any standard of fair dealing that can be properly policed. If a sister corporation set-up were even to be thought about, at a minimum any company dealing in securities should have a different name, a different location and not be able to obtain financing from any sister bank and be prohibited from being in any deal where a sister bank is supplying credit. I even think that discussing this is really putting the proverbial cart before the horse.

We all have to sort this business out. The securities industry has said that it supports a moratorium and I think that makes a lot of sense. I know, Mr. Chairman, that you will tell me that a moratorium is just another excuse for Congress not to take any action and that Congress doesn't need any excuses to go slow or do nothing. However, from where I sit, I see no reason to set in motion a series of events when we don't know what we want or what will happen if these changes are made.

I think we in America ought to be pretty satisfied with the way that the financial markets are working. Why should we legislate such changes anyway? I certainly know that Citibank and its cousins want to be everywhere and do everything, but I don't think that that's a reason for making changes such as this. A few years ago we all agreed that what was good for General Motors wasn't necessarily good for America. I feel the same way about Citibank. What's good for Citibank may not be good for the rest of us. It's a fine company and well run in most areas, from all I can tell, but just because it wants to be on every street corner in America doesn't mean that it's good for America that it be there. Their newspaper ads say "The Citi never sleeps." Boy, do I believe that.

There is tremendous competition within the securities business right now and it is every bit as competitive as it was 20 years ago. Anybody can enter the securities business except for banks. That's a pretty wide field of choice. What I think will happen if banks can get into this business or the real estate business or the insurance business is that they will in the not-too-distant future strangle competition with their inherent clout. There will be fewer players, less, not more, competition. I recognize that the sister corporation idea takes away the advantage banks have in deducting the interest costs of municipal bond inventory and also makes it possible for the Securities and Exchange Commission to regulate the securities business separately, but beyond that I don't think it does much. The uniqueness of bank credit power remains.

I recognize the problem that exists with some of the federal regulators who want to use the same Glass-Steagall loophole I spoke of earlier to allow state banks which aren't members of the Federal Reserve System to sell common stock. I think that is a terrible idea and should be stopped. And this current competition that is going on among states to loosen bank regulations or to let banks enter heavens-knows-what businesses - insurance, securities - should be stopped. National financial policy should be established in Washington, not Pierre, South Dakota or even Salt Lake City.

I'm for a moratorium. I'd like Congress to blow the whistle and get on with figuring out what's better. Not better for Citibank or Dean Witter, but better for America. How Congress tackles the problem, whether each banking committee should develop its own studies and reports, whether a commission should be established of people from the industries involved, I leave to Congress. But before we jump out the window into the brave new world we should have a better idea of what the lay of the land is beneath us. We don't want another sluggish financial landscape dominated by a few giant banks, like Germany's.

Thank you Mr. Chairman for the time. I hope these few remarks have been useful. I certainly am ready to answer any of your questions, although I am not an expert in these matters. I just believe strongly in the principles I have stated.

[EDITORIAL COMMENT: Whereupon, the statement of Mr. Dance will be inserted into the record with the following changes: (1) On page 3, paragraph one, starting in the middle of the paragraph, was changed as follows: "I know this is true because I have been in the insurance business for 10 years prior to this and I know it happens." The rest of the paragraph is deleted. (2) On page 4 near the end of the page the following words were deleted: "They would buy the advisory firm and not the clients' assets managed. The stock of all mutual fund advisory firms are worth about $49 billion while * * * " The statement continues with, 'The assets of Bank of America and * * * " (3) Added to the end of his statement on page 7 are the following sentences: "The banking system is conflict prone, concentrated, and becoming more so. I don't believe we want to accelerate those trends nor to encourage any actions which have the slightest chance of undermining the stability of the financial institution."]

[Complete statement follows:]

Revised March 1, 1984

TESTIMONY OF HAROLD W. DANCE
BEFORE THE UNITED STATES SENATE COMMITTEE ON
BANKING, HOUSING AND URBAN AFFAIRS

SALT LAKE CITY, UTAH
January 16, 1984

My name is Harold Dance and I am President of Harold Dance Brokerage, a securities brokerage firm located in Logan, Utah. I am a graduate of Utah State University and have an M.B.A. from Harvard Graduate School of Business. I am a charter member of the International Association of Financial Planners and one of the first four people to pass the exams to become a certified financial planner. I also have a professional degree in Property and Casualty Insurance - CPCU. I operate a securities firm and act as an insurance broker. I greatly appreciate the opportunity to testify before you today.

My testimony will deal with the legislative proposal currently being considered by your Committee which would authorize affiliates of commercial banks to sponsor mutual funds and to distribute their shares to the public.

My views regarding this proposal are based on my experience as a distributor of mutual fund shares and other securities to our clients located in the State of Utah. I have been in the securities business for 25 years. My firm prides itself on the personal services which we render to our clients. I also welcome competition from other firms engaged in the securities business, ranging from other local Utah broker-dealers to national securities firms with offices in this State. However, I believe that entry by commercial banks into the mutual fund business would create an inherently unfair system of competition. I don't know what this would do to the few giants in the securities business like Merrill Lynch but I can tell you that it would probably put the small securities firms out of business.

Commercial banks enjoy a number of major economic advantages over securitie firms and all other businesses. Banks have a governmental license to accept deposits; these deposits are federally insured and this enables banks to obtain funds at lower cost4s than securities firms and other businesses. Banks have ready access to low cost capital through access to the federal funds market and the Federal Reserve Board's discount window. My firm and other securities firms do not possess these advantages. I believe that it would be grossly unfair to permit commercial banks to compete with us in the mutual fund business utilizing their cheaper cost of funds derived from these special economic advantages.

Equally important is the fact that banks are the dominant source of credit to business firms and individuals in the State of Utah. Every business and every individual relies on his bank for loans. And every borrower naturally believes that his bank will be more inclined tc extend credit to him if he purchases other products and services from his bank. This is simply human nature. Similarly it would be simple human nature for a bank officer who is considering whether to make a loan to a customer to "recommend" that the customer purchase mutual fund shares and insurance from that bank and in a fund sponsored by that bank or its correspondent. A list of loans would be kept and the bank's insurance and mutual fund departments would be expected to complete the account. The employees of these departments would be harassed until the package was sold with all the coercion of the loan as a backup. I know this is true because I have been through it in the insurance business. If banks are permitted to enter the mutual fund business, our customers will naturally feel pressure to buy fund shares from the banks which make them loans rather than dealing with independent securities firms. This is not fair nor is it to the advantage of the public in the free choice of financial services.

I realize that some Utah bankers may believe that it would be to their advantage to be able to sponsor mutual funds and to offer fund shares to citizens of Utah. However, I think that enactment of the proposal would not benefit Utah bankers and could actually be detrimental to them. Banks have the reputation of safety; security brokers of risk. The sale of securities by banks may well cause a loss of confidence in the bank's reputation for security.

I believe that few, if any, Utah banks will sponsor their own mutual funds. In fact, a 1983 study prepared by Arthur Young & Company for the American Bankers Association concluded that "For the small community bank, fund management is not cost effective. A community bank cannot generate the critical mass, the break-even volume, that is required to profitably manage funds." Instead, if the proposal is enacted, I believe that it will only be utilized by the giant money center banks located in New York, Chicago and Los Angeles.

I also believe that many large banks located in New York, Illinois and California will not even create their own mutual funds. Instead, it is likely that they will simply acquire existing mutual fund organizations. Again, recent history proves this. When Bank of America decided to enter the discount brokerage business, it did not start a discount brokerage operation. Instead, that giant bank simply went out and bought the nation's largest discount brokerage firm. I understand that Senator Garn has proposed limiting the amount of capital which large bank holding companies can utilize to acquire mutual fund operations. However, the limitation misses his objective. Even under the proposed limitation, a handful of the nation's largest bank holding companies could still acquire the entire mutual fund industry.

This is due to a combination of two factors. First, the large bank holding companies are so big that, even under the proposed limitation, they still have huge sums to use for acquisitions. Citicorp, for example, had $11 billion (including long-term debt) in total capital at the end of 1982, and would be allowed to spend $2.8 billion to acquire financial institutions. Second, the entities to be purchased in the mutual fund business are the management companies, which are very small compared to the mutual funds they operate. For example, the Calvert Group is a management company that was recently purchased for $12.5 million, while the assets of the mutual funds it managed were about $1.25 billion, one hundred times as large. So if Citicorp received this same 100-to-1 ratio in spending its $2.8 billion, it could acquire firms managing mutual funds with about $280 billion in assets, virtually the size of the entire mutual fund industry.* I don't see how such developments would benefit the public, securities firms or Utah banks. There will be a formidable concentration of power and potential for abuse.

Nor do I believe that local Utah banks would serve as the exclusive distributors for mutual funds created or acquired by banking giants located in New York, Illinois and California. Instead, if the legislation is enacted, I believe that it is likely that the large money center bank holding companies will distribute the shares of their mutual funds through the Utah offices of their non-bank subsidiaries.

In short, I believe that enactment of the legislation would not benefit Utah banks. In fact, the legislation would simply enhance the position of out-of-state banking giants at the expense of both Utah securities firms and Utah banks.

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*If Citicorp's long-term debt is excluded from this calculation, Citicorp could "only" buy 52% of the mutual fund industry.

History shows that the Glass-Steagall Act separating the banking and securities industries came about because of abuses and conflicts of interest and the concentration of power resulting from the continuation of these two activities. When large amounts of other people's money become available with substantial conflicts of interest for the use of that money, the banks have shown that greed has overcome prudent care of people's money when the bank or its departments are in trouble. This was true in the 1920's and was again demonstrated in the 1970's with the real estate investment trusts. REITS were an example of widespread, serious mistakes and abuses with the result of substantial losses of people's money invested for them by banks. There is a scripture which says "It is the nature and disposition of almost all men as soon as they get a little authority, they will immediately begin to exercise unrighteous dominion."

The ultimate irony would see the enactment of the pending legislation which would subject banks (whose conduct in the 1920's was considered so abusive as to result in their exclusion from the mutual fund business, plus their abusive performance with REITS in the 1970's) to the lightest restrictions of any financial entity subject to the securities laws.

This is not a consumer-driven bill but is being demanded by the huge banking institutions aggressively seeking to expand their market share. I don't see angry consumers who have demanded that they be allowed to buy mutual funds or insurance through their banks.

Whether banks are permitted to enter the fund business should depend on whether this action benefits the public more than it aggravates trends toward bigness in banking, concentration of bank power, and conflicts of interest within the banking sector. I do not see any hard evidence to suggest that bank entry into mutual funds would yield sizable net benefits. In fact, potential disadvantages seem likely to overwhelm whatever positive benefits may flow from this sharp break with the past. Three years ago the banks were talking about an uneven playing field in competition with money market funds. The playing field has since been tipped in their favor with insured money market deposit accounts now available to banks. But now the giant banks want to take over the whole field.

In conclusion, I greatly appreciate the opportunity to testify before you today. Enactment of legislation authorizing affiliates of commercial banks to sponsor and distribute mutual funds would be detrimental to smaller securities firms. It would not be in the best interests of smaller banks. Above all, it would not benefit citizens of this state and could, in fact, cause a serious concentration of power to the possible serious weakening of the financial security of our nation. The banking system is conflict prone, concentrated, and becoming more so. I don't believe we want to accelerate those trends nor to encourage any actions which have the slightest chance of undermining the stability of our financial institutions.

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The CHAIRMAN. Gentlemen, I appreciate your testimony. I don't want to be misunderstood. I am going to make a few comments about this because your testimony, and I don't mean personally or individually, is somewhat frustrating to me.

After several years of listening to testimony, the theme of what you are saying is, "If it isn't broken, don't fix it. Watch out for the big banks." And it's easy to bring up Citico[illegible] and Bank of America. They're the big bad guy. Aren't we great; we're after the big guy.

There are 15,000 banks in this country. There are 5,000 thrifts. Most of them are small, as I said earlier. I was bragging about First Security to Senator Lautenberg, but it is a small bank. The Senator is right; relatively speaking it is small. Most of the banks that we are dealing with in this country are small, local, or regional banks. Certainly the savings and loans are, for the most part, and the thousands of credit unions are. So when you start looking at the situation these issues have been developing over a number of years—and somehow I always get the impression from your testimony that it is the administration that is causing the changes. Glass-Steagall was good enough 50 years ago. The marketplace was different 50 years ago.

I was born in 1932 so I don't have first-hand knowledge of the marketplace then but obviously what I say is true. There were incredible abuses and banks failed because of those abuses and people lost their money because of that and people killed themselves and jumped out of buildings because of that. And Glass-Steagall and many other revisions were in response to that. But everything was nice and neat, and compartmentalized.

If you go back far enough to where I had a full head of hair, if you weren't here this morning, and Kay knows how long ago that was because Kay and I have known each other since grade school. Mr. Davis' partner and I went to naval ROTC for 4 years together. Virtually every witness that has been here today was an old friend of mine over a long, long period of time and none of us are old enough to have first-hand information of that time. But I understand completely why Glass-Steagall was created and I agree with the separation of commerce and not I or anybody else is in favor of the banks getting involved in general commerce and there are no proposals to do so. We don't want them buying Sears, or Merrill Lynch, or anybody else and getting in the area of general commerce.

Glass-Steagall is broken in the marketplace. Not by Jake Garn, the Senate, the Congress, or anybody. It is amazing to me that I am not capable of being in the insurance business today because I have been out of it for 12 years. It is an entirely different business in the way it functions. If I had my choice, being a Senator from a small State, I would never be for interstate banking. I would not be for any of the proposals that are in this bill. But, nor would I be for Sears getting out of the retail business and owning a savings and loan, having scurities, car insurance, life insurance and S&L all in one store. I wouldn't be in favor of Merrill Lynch having created CMA's. In other words, it would be nice to have it in a neat rolltop desk with each person in their own compartment in separate. But that isn't the real world.

Every one of you in every segment—and I'm not talking about you personally, I'm talking about securities, banks, savings and loans—everybody has wanted to branch into somebody else's business but they don't want to admit it. They want to say: "Those guys are raiding my business. Keep them out. But let me raid theirs." It's like in Korea. We couldn't go north across the Yalu. But the Chinese could raid us south across the Yalu all they wanted to.

You go back 3 years and I didn't see much sympathy for the banks. Let's separate the 10 or 12 largest banks. They will survive, come hell or high water, with or without legislation and mutual funds and all the things.

Senator LAUTENBERG. Except IMF.

The CHAIRMAN. The Bank of America's will survive without IMF. They will be here when all the rest of us are gone.

My concern is the medium and small firms. That's what I look at. The big boys, forget it. You can talk about them and blame them. Citicorp, Bank of America, and Chase will be around forever. They are big enough to solve their problems.

What about the others? Look at the money market mutual funds situation. Nobody was crying about that at the time. Yet we had the financial system in this country on the skids. If you want to look at the savings and loans in this State, it would scare you to death. I can talk about it more now, now that we are all right. But you can't believe some of your good friends, that you talk about, and banks in the State as well as across the country both, the troubled list for S&L's nationally and for banks was the highest in the history of this country; even higher than during the depression. We had more failures in both in 1 year than the entire history of the Federal Home Loan Bank Board.

BILLIONS OF DOLLARS FLOW OUT FROM DEPOSITORY INSTITUTIONS

There were several reasons for that but one of them was money market mutual funds. I don't remember any consumers demonstrating in the streets for those, but he saw a demand and filled it and it was easy. And more than $200 billion flowed out of the depository institutions of this country and hundreds of millions in most of the small States. That money wasn't available any more to make agricultural loans, automobile loans, farmers' seed in spring, or his equipment, and all that. An incredible outflow. It had never happened before in this country.

I didn't hear the securities industry, at that time, saying, "Hey! We are trodding on banks." I couldn't get anybody to admit that the CMA's were third-party transactions on which people wrote checks to pay their bills in spite of the fact that they say $500 minimums. Bank One in Ohio did not refuse to honor a $25 or $50 check. That's where I got involved and said there are two ways to go and this is unfair.

I understand your testimony. I understand what you are saying. Most of it is correct and most of it I agree with. But you can't say, "Keep everybody else out of our business and let us raid yours." I am not talking about you three individually. I am going to clarify what I said before over and over again. Especially after what happened last week. I am going to be careful about what I say and what phrases I use.

But you face that problem and I face problems as chairman of the Banking Committee that I have failing institutions of magnitude. That's why we raised depositors insurance to $100,000 and why we had mergers rather than buy-outs of peoples' deposits. So that even the ones over $100,000 were not losing their money and recreating a panic. I can't tell you how serious the situation was just 2 years ago in this country. It wasn't money market funds alone but that was a very significant factor in the outflow of money. And when you say the big banks wanted these things, the big banks were doing fine with money market funds because where were they placing the money? CD's; $100,000 CD's. I said, "Why don't you put some back in the small banks in New Jersey and Utah and everyplace else?" "We can't. We can't break up the figures and they can't handle $100,000." If you think the big banks were hurt, they weren't. Their profit margins were down but they will survive.

The money was flowing into big jumbo CD's and who was getting killed? The little guys in every industry.

When we talk about concentration, let's talk about economic concentration—whether it's big banks, securities, or big insurance. There's awfully big companies in the securities business and in insurance, too. And when we say, "Don't fix Glass-Steagall," that's fine if Prudential wants to give up banks and American Express wants to give up Shearson, and we talk Dreyfuss out of buying a bank in New Jersey. But they have one in New York and one in New Jersey. One place they don't have demand deposits and they don't make commercial loans in the other. So they are not a bank. But put them together and they are a bank.

I don't want to take more time, but this is another side to this and the security industry is not lily white in this thing and I wish the securities industry would pull out of it and I could tell banks to jump in the lake.

LET'S LOOK AT BOTH SIDES OF THE COIN

But you have to realistically look at that side of the coin and see what everybody else is trying to do. Tell Sears to give up their full financial centers and put everybody back in their compartment. Like I said, if that were possible, that's what this Senator would like to do. But it isn't. There's no way to put the genie back in the bottle.

In other words, there is no way that this Senator, as long as I am chairman of the Banking Committee, is going to say, "Let's maintain the status quo. Let everybody else raid the depository institutions," and I am talking about the small- and medium-sized guys because I can't repeat enough that the big boys will take care of themselves in every field—securities, insurance, and banking. They will be around. That's what we need to avoid.

In the bill it lists the 25 largest banking institutions. Those restrictions are based against the 25 largest whatever financial institutions, not banks. That includes securities and insurance as well.

So there is nobody in this room who wants to prevent concentration more than I, but wherever they fall and in whoever's industry they fall. That includes big banks and big insurance companies and big securities firms so we can try and protect the diversity that Kay talks about.

We don't want a banking system like Germany has. We don't want a central banker with the power of Australia with only four banks. And most of the rest of the world.

We have been blessed with a dual banking system with a great diversity of products and services of institutions throughout not only banking but securities as well. We do have the best security industry in the world too and we have the best insurance industry all the way. So my job is to try and look at the overall picture and that's what I am trying to do.

So you can't just say—and, again, I don't disagree with most of your testimony, not one bit. But simply, you've got to look at the other side of the coin too and say, "OK, we don't want banks in our business and we have to stay out of theirs." Again, the big banks are benefiting by mutual market funds. We have the giant C.D.'s and the whole thing. Who gets hurt? The little boys and homebuilders. The realtors and the independent businessmen across the country.

So I put all three in the same category as far as this concentration. And if it were possible to have gone the other way, but we found out here in Utah that it wasn't. I don't know if you three were involved in the fight in the Utah Legislature. I stayed out of it. I said I was not going to get in it. But you know what they tried to do to you. They tried to prohibit you from offering checks on money market funds. And that's fine if they can get away with it. They didn't. I didn't agree, frankly, with them trying to tell you not to. But I don't think you can logically make that argument and say, "We want to be in the banking business but we don't want them in ours." That's all I am trying to explain, and have done so for years. I don't succeed too well.

I have no great pride of authorship. I tried to get the consensus of the affairs. I don't mean to take it out on you but I'd like that understood, that there is another side to this coin of business and it isn't just big banks that should be feared. It's big business in any of those industries. We ought to try to foster competition.

The securities industry will quit getting pressure from banking industries when they quit trying to get into somebody else's business.

I'll never forget when Don Regan became Secretary of the Treasury and he was overwhelmingly considered to be biased, that there was no way he could possibly treat anybody but the securities industry fairly. So I asked him the question at the Banking Committee hearing. He said, "Of course I can. As the man that started all this trouble. How better to be on the other side and correct it than if I hadn't been the originator of it."

I don't criticize anybody in this country in any industry for finding a better way to serve their customers. The issue of interest rate ceilings was before money market funds ever existed. The CMA's. I could never understand why we had Government telling financial institutions how much they could pay their customers. Never understood why they said, "All you can get is 5¼ or 5½ percent." I don't think that's Government's role to dictate what a person can earn on their money.

So before this issue ever came up, I was opposing interest rate ceilings, regulations, differential, and those types of interference. That's as a consumer. I am hardly known in the national consumer groups as proconsumer. But that's a consumer issue. People are entitled to what the market will pay them. That's credit allocation, or rationing of money, or whatever you want to call it.

Now that you have heard my speech, which I didn't intend to give today but you prompted me to do it, and Kay will understand. He knew me when I had a full head of hair, which was a long time ago. But I would appreciate each of your responses to what I said about the other side of the coin and I know which came first, the chicken or the egg. But your response to the other side of the coin as far as the securities are involved and insurance and other types of activities; insurance companies buying banks. That side of the coin as well as concentration of economic power and not only the fear I share with you in large banks but in insurance and securities firms as well. Kay?

Mr. BURBIDGE. You'd really like me to respond to that, Jake?

Senator LAUTENBERG. I'd like to respond, if I might, before we hear from our witnesses.

The CHAIRMAN. Let me just say that in the interest of time, if you would like to submit them in writing, that would certainly be acceptable.

Senator LAUTENBERG. I would like to make a couple of comments because you have the advantage of home court and friends and——

The CHAIRMAN. I'll come to New Jersey.

Senator LAUTENBERG. I think I'm going to walk away with some of your friends, I think, in this exchange.

We have had a good time together in the year we have been associated. Mutual respect as well as mutual differences on some issues. We had the opportunity, occasionally, to air those things in Singapore, Hong Kong, Japan, and other exotic marketplaces where the United States has a very significant stake. I would have to say, Jake, that I thought the testimony of these individuals was clear, lucid, articulate and, for me, very helpful. I would have to tell——

The CHAIRMAN. Let me add that I didn't say it wasn't clear and lucid.

Senator LAUTENBERG. No. I keep hearing in reference to when you had hair and I'd like to know when that change took place. I can tell you that a lot of my friends would tell you they don't remember me with black hair.

The CHAIRMAN. Don't worry about the color. Take it any color you can get it.

Senator LAUTENBERG. I know you weren't critical, and the only fly I saw in the ointment was when Mr. Dance talked about the fact that he was proud of his MBA from Harvard. I sit on the Columbia school board and am a graduate from that school. I wanted you to know we have equal time.

On a serious note, it was very helpful to me to hear the point of view of those who make a living in the local marketplace, and I include you even though your firm is a national firm. You have identified yourself very clearly with 25 years in this marketplace.

Mr. **Burbidge**. Twenty-eight.

Senator **Lautenberg**. I am concerned about the other side. The other side is the big banks who you, Mr. Chairman, identified as being able to succeed no matter what the conditions and they will certainly do that. They have been the recipients, very frankly, of operation rescue as we all know because of some of their mistakes and I supported that funding with your leadership because I felt that it was an essential for the preservation of a reasonably stable financial marketplace. But we did help some of our friends get through problems that they had incurred entirely on their own without any help from the outside.

What I see now, and that's why I said this testimony was very helpful to me, is to hear the other point of view because what will happen, I'm concerned, is that we will see the concentration in the hands of the few larger banks. I know in your legislation, and I am generally very supportive of Senator Garn's legislation, you did try to limit the merger activity. But I think the yardstick, very frankly, is not restrictive enough and we will see huge enterprises come out that could very easily over the airwaves and other ways encroach on the business of local people who service the marketplace very well and have done so for a number of years.

The **Chairman**. Let me add and clarify so there's no misunderstanding. Chairman Volcker and I discussed this this morning and we may disagree with the mechanics. I have no price of authorship in that attempt. It was a starting point to indicate that there was a concern about concentration in all different areas. However that formula worked out, I think we would be in general agreement that there needs to be limitations placed, however they are written. Legal beagles can argue about mechanics. Senator Lautenberg and I don't happen to be among the profession. We know some people we can hire. Some of our best friends are attorneys.

Senator **Lautenberg**. Some of our best colleagues are attorneys. I do think the process begun here, Jake, has been helpful. The testimony of all the witnesses has been very good. The fact that the people here and the panel before differ in point of view. It was refreshing for me to hear one group of bankers say one thing about interest rates and another group of bankers say something else. That explains the nature of the controversy. The fact that Chairman Garn is going through the routine of examining the question is very complicated. There is no easy answer, as any one of us knows who heard persuasive arguments in each phase of the industry.

For me the ultimate concern is for the consumer. Will he be better off or worse off when this thing is over in terms of the total array of services, not just making investments of buying insurance. I am concerned.

The industry that I came out of—and I don't know if I told you this Jake. But when I graduated from business school, I went to work for Prudential as a management trainee. I remember lots of small enterpreneurs who made a decent living as insurance people. I am concerned that we will eliminate part of that profession or even the travel agents which were under discussion. It's the wrong thing for the banks to be looking at the little businesses that service the community very well.

So there's a divergent array of things that we have to look at and I would like to compliment today's panel and the others that have been before us.

The CHAIRMAN. Rather than take the time now, I won't pursue the question. But I would appreciate it if you would give me a response in writing to the other side of that coin because, again, Senator Lautenberg and I don't disagree with you about the dangers of bank concentration but we have to address this problem.

MORATORUM IS A DISTINCT ADVANTAGE FOR SOME

Some who talk of having a moratorium. These issues don't get any easier to address. The longer they go, the more difficult they become to address. But if you put a moratorium on, the only thing that does is for the people that are already there, like Sears. They'd love a moratorium. They won't admit it but so would most of the others who have already introduced it in the industry. They'll say, "Let's have a moratorium." That helps them out. A moratorium is a distinct advantage for those that have already entered the field to the exclusion of those who may want to. That's a fundamental reason for being opposed to a moratorium.

Whether it's to stall for Congress or not and I'm not suggesting a divestiture, let's go back to square one and everybody get rid of what they have until we solve the problem. I may be foolish but I'm not crazy enough to try to get involved in something like that.

But I would appreciate your responses very much. I appreciate your testimony today. Thank you very much.

[Additional remarks by Harold Dance and Kenneth P. Burbidge, Jr. follow:]

HAROLD DANCE BROKERAGE
Financial and Retirement Planning
440 North Main Street – LOGAN, UTAH 84321

February 6, 1984

Senator Jake Garn
Federal Building
125 South State Street
Salt Lake City, Utah 84111

Re: Hearing Before Senate Banking Committee in
Salt Lake City on January 16, 1984

Dear Senator Garn:

I testified at the Senate Banking Committee hearing in Salt Lake City on January 16, 1984 about the adverse impact your bill, S. 2181, would have upon securities firms, banks and consumers located in Utah. Following my testimony and the testimony of two witnesses from Salt Lake securities offices, you expressed views about which you requested written responses from each of us. In preparing this response, I have had the advantage of reviewing the portion of the transcript containing your remarks, a copy of which is enclosed. I have also enclosed a copy of my written statement, with some minor changes, which I read at the hearing.

As I indicated at the hearing, I have my own insurance and securities brokerage business in Logan and have served this community by offering insurance and securities services and products, including mutual funds, for 25 years.

My concern with S. 2181 is that if commercial banks are able to sponsor and sell mutual funds, as well as insurance, it will destroy or severely injure the business I have built up and will do the same to others like mine throughout the state and the nation. In the free market economy most of us claim to believe in, this is a reality that I and others similarly situated would simply have to face. However, it should not be allowed to happen in this instance because I am convinced it will be to the clear disadvantage of the consuming public. I will try to indicate why I believe this is so in response to the comments you made at the hearing.

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C F P *Certified Financial Planner*

You indicated a number of times at the hearing that the securities industry has been providing banking services and for this reason members of that industry cannot complain about banks being empowered to offer services historically provided by the securities industry. You cited the offering of money market mutual funds as an important example of bank-like services provided by the securities industry. You also said that the money market funds played a role in the weakening of quite a number of small and medium banks and savings and loans a couple of years ago.

I believe that if there was a time when the money market funds could be held up as a reason for allowing commercial banks and other depository institutions to sell securities, and particularly mutual funds, that time is passed. I was involved in the legislative contest in Utah in 1981 to which you also referred and in which the Utah banking industry attempted to persuade the Utah Legislature to limit Utah consumers' access to money market funds. While money market funds have important factual and legal differences from bank deposits, a significant portion of the people of Utah viewed the funds, which were yielding as high as 16% or 17%, as a superior alternative to placing their money in passbook savings accounts at 5-1/4% or 5-1/2%. As you are aware, the reason many state legislators voted against the influential Utah banking industry was because they received more calls and letters from Utah consumers opposing the banks' bill than they had ever received on any other legislative measure. It was a consumer issue and I believe it is unquestionably true that the majority of those Utah legislators who voted the way they did, did so in response to the public outcry rather than as an expression of favoritism towards a particular industry.

To the extent that the increase of monies invested in money market funds in 1981 and 1982 came out of passbook deposit accounts of small and medium banks and savings and loans, it was the result of consumer demand, fueled by unprecedented inflation which made passbook savings untenable. (Money market funds had been available and virtually ignored by the public for nearly ten years before inflation made them attractive).

Any injury caused to small and medium depository institutions has been redressed by the Garn-St. Germain Act which authorized the money market deposit accounts which banks have been offering for the last couple of years. Congress also authorized banks to offer these deposit accounts with FDIC insurance, tipping the playing field in favor of banks. Most money market mutual funds do not offer any kind of insurance. Since they have offered these insured money market deposit accounts, depository institutions have been infused with deposits exceeding twice the amount presently invested in money market mutual funds.

In view of this history, I was very troubled that you would point to the money market mutual funds at the hearing as being a reason for allowing banks to offer equity mutual funds, when banks have done so well with their new insured deposit accounts (you indicated at the hearing that the danger to the many small and medium depository institutions has now passed), and when there has been absolutely no request from the public, as far as I am aware, that banks offer them. Indeed, I have not heard any expressions of interest, and certainly no calls of need, from the small and medium banks with whose interests you are concerned. At the hearing no representative of any Utah depository institution expressed any interest in sponsoring or selling mutual funds, and I have not heard any expressions of interest from any other Utah banker.

The only banks I am aware of who are interested in offering money market mutual funds and other mutual funds are the big national banks about which you indicated you had no interest in protecting.

The nature of the mutual fund industry is such that generally only large financial institutions--larger than those in Utah--can offer them, although smaller institutions could act as distributors. If Utah banks were authorized to distribute mutual funds, including money market mutual funds, I have no doubt that they would be able to do so to the substantial injury of my business in Logan, and to others like it elsewhere, even if the competing products they offered were inferior and more expensive. My customers would be the final losers.

The reason banks could do this, as I indicated at the hearing, is because they are the paramount business influence in any community. They are the ones who make the loans, without which most small businesses and farmers would not survive. They are clearly the dominant force in Logan's business community.

I will not repeat the testimony I gave at the hearing except to say that I know from many years of personal experience that, whether outlawed or not, banks will use their loan leverage (they probably cannot avoid using it) to sell all the other financial products they are authorized to sell, and that this will result in the concentration of these products in banks to the exclusion of others like myself in the financial services industry. For many small businessmen and farmers there will be no choice; they will simply purchase the mutual fund shares offered by their bank, regardless of price or quality, or they won't invest in mutual funds.

Small and medium banks do not need to sponsor or sell mutual funds in order to prosper and neither the consuming public nor those who currently sell mutual funds need the injury that would be caused if banks were authorized to sponsor or sell them.

You indicated that we have a new marketplace and I took you to imply that because of this Congress has no choice but to allow banks to offer new financial services and products. And it is true; there have been changes. Certainly the inflation of a couple of years ago and the rise of money market funds and the money market deposit accounts have made consumers much more aware of alternative financial services, but it is my view that the major changes in the marketplace that are being talked about are more anticipated than realized. In Logan there has been little change, as I would expect in most small communities across the country. It is my view that the changes you speak of are primarily those which the large financial institutions of this country hope will come about by reason of this or other proposed legislation.

In connection with market changes you made a reference to the so-called non-bank banks acquired by Merrill Lynch and Dreyfus, although I believe you would agree that those acquisitions represent only a symbolic penetration and have not had any measureable impact upon the nation's banking industry. These acquisitions only occurred due to the questionable activities of federal and state banking agencies. It is something that Congress can easily deal with one way or the other. In this instance, unlike the money market funds two years ago, the market place has not presented Congress with a fait accompli.

You also mentioned the mergers involving certain financial institutions, and you pointed to American Express' acquisition of Shearson, Prudential's purchase of Bache, and Sears' merger with Dean Witter. I do not understand how the merger of these non-banking institutions constitutes a reason for allowing commercial banks to sponsor and sell mutual funds. Nor do I understand how these mergers could diminish the market share of small and medium commercial banks. Moreover, I do not believe these mergers have affected them. (To the extent that Shearson-American Express, Prudential-Bache and Sears-Dean Witter offer money market mutual funds any harm caused to depository institutions in the past has been properly redressed by the Garn-St. Germain Act.)

I believe that I and other small securities agencies in Utah have served our communities well in offering competing, although different, financial services and products than those offered by depository institutions. I am convinced that the consuming public benefits by the division of these financial services. The law which has divided these services has not been undermined by the market place, in my view, nearly to the extent you indicated. I believe it would be unfortunate if this division were eliminated wholesale because of the false notion that the securities industry has gotten into the banking business.

I very much appreciate your inviting me to respond to your remarks. I would welcome the opportunity to discuss this matter further with you. If you believe this would be helpful, I would be happy to meet you the next time you are in Salt Lake or I would be pleased to discuss the matter over the phone. I must say I was very pleased that you brought your Committee to Salt Lake to hear local witnesses address these issues. I would encourage you to do it again. If I can be of any further assistance in your consideration of the proposed legislation, do not hesitate to write or call.

Very truly yours,

Harold Dance

Harold Dance

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1984 MAR -5 PM 4:40

KENNETH P. BURBIDGE, JR
First Vice President & Branch Manager
Northwest Region

March 2, 1984

Senator Jake Garn
SD 505 Office Building
Washington, D.C. 20510

Dear Jake:

You asked that I answer your comments of January 16 in writing. I looked over your comments made following my testimony and would like to address the other side of the coin that you mention, but would like to stress the point that I felt was most pivotal in the securities industry's testimony.

Banks have and can exert a tremendous influence over an individual and/or corporate entity. The clout that this industry possesses is enormous. The securities industry, with our entry into levels of the banking category, really do not carry with them any semblance of the power or authority that a bank can exert on a depositor or lender. I agree that an institution like our own would like to be able to provide many and most financial services. Our industry has evidenced that we would do so on a very competitive basis and with excellent results for the ultimate consumer of our services.

We have seen "nonbank banks" spread throughout the country despite the laws barring interstate banking. I realize that Congress is looking at this situation and would legitimitize the nonbanks. The Securities Industry Association looks upon banks that offer discount brokerage services as nonbroker brokers. It looks like the linguists are enjoying the competitive struggle between our financial institutions. Financial papers, periodicals, et cetera have and are carrying articles daily opposing the giant banks moves into their own states. You will recall, I called this backyard competition in my testimony.

I read yesterday that your counterpart, Fernand St. Germain, Chairman of the House Banking Committee, has now called for precisely what I asked for, a slow down in deregulation to see how it will actually affect the consumer and business entities. Representative St. Germain, in the Wall Street Journal article of March 1, acknowledges a brakes-on attitude for deregulation, "Banks-depository institutions-are not like any other business. They have a unique place in the economy and their money and credit powers give them leverage not matched by any other industry." He may have said it better, but I said it first on January 16, "I'm for a further study period. I'd like Congress to blow the whistle and get on with figuring out what's better. Not better for Citibank or Dean Witter, but better for America."

In conclusion, let me say it was indeed a pleasure to appear before you, and yes, how well I remember you with hair.

Very sincerely,

Ken (Kaz)

Kenneth P. Burbidge, Jr.

Next we have panel 4: Kenneth Osborne, president, Superior Insurance Service, Salt Lake City; State national director, Independent Insurance Agents of Utah; and David Kelly, agent, National Life of Vermont, Salt Lake City; president, Utah State Life Underwriters Association.

Ken, would you like to begin.

[EDITORIAL COMMENT: Whereupon, Mr. Osborne's statement will be inserted into the record with the following changes: (1) The first sentence of the statement is as follows: My name is Kenneth Osborne. I'm an independent insurance agent. Utah is my area of sales. At the present time, I serve as State national director from Utah to the Independent Insurance Agents of America. (2) Page 4. The second sentence in the third paragraph of that page begins, "Congress and Congress alone must determine XXX."]

[Complete statement follows:]

STATEMENT OF KENNETH OSBORNE, PRESIDENT, SUPERIOR INSURANCE SERVICE, SALT LAKE CITY; STATE NATIONAL DIRECTOR, INDEPENDENT INSURANCE AGENTS OF UTAH

Mr. Chairman, I am grateful for this opportunity to testify on behalf of insurance agents in Utah, agents who share with their colleagues across the country a deep concern over the direction financial institutions reform will take. And, I don't think it would be presumptuous of me to say that I testify today also on behalf of my clients whose interests, like mine, will be affected in a variety of ways by banking deregulation. In an important way, my clients, and the clients of every insurance agent, are a large part of the missing ingredient in the financial institutions debate: the general public, in whose name and in whose interests many of the proposals before your committee are made. Speaking only from my knowledge of my clients, I can tell you they are less certain of the benefits to them from deregulation than many of the architects of these dramatic revisions in banking seem to be. I have not noticed any angry consumers demanding they be allowed to buy insurance through their bank.

Insurance agents, of course, have long been concerned with the combination of banking and insurance. For about a dozen years in the courts and in congress, insurance agents have argued the case for limiting banks' authority to sell insurance. This effort culminated last year with the enactment of the Garn/St. Germain bank reform bill, Title VI of which for the first time places explicit limits on bank holding company insurance authority.

Congress was persuaded to establish this statutory restriction for both historical and practical reasons. Historically, the separation between banking and commerce has for 50 years limited most banking institutions' authority to engage in insurance activities. In this context, only bank holding companies under the bank holding company act could, at the Federal Reserve Board's discretion, sidestep this longstanding separation. The Garn/St. Germain bill extended to bank holding companies and their subsidiaries the insurance restrictions that historically have applied to all national and most state banks.

Practically, Congress recognized the anti-competitive effects implicit in banks' control of credit. The combination of credit and insurance, Congress found, both constricts the consumers' ability to choose insurance free from the influence of credit, and unfairly competes against other sellers in the market who have no power to extend or withhold credit.

Whether direct or implied, the results of the credit tie in are the same: consumers purchase insurance from banks to protect their source of credit, not because insurance is available at lower prices or with better coverage and better service. And the rest of the market is fenced away by the insurmountable and unfair competitive barrier of banks' control of credit. Therefore, bank insurance sales actually choke off competition rather than generate it. Competition never has a chance to function.

Insurance sales are uniquely vulnerable to this kind of direct or implied coercion as, unlike other services a bank may offer, only insurance is required for a borrower to qualify for credit, and insurance coverages are almost always certified at the point of the loan transaction.

Most people will grasp the validity of the credit tie in argument, but for skeptics there exists a large body of academic studies, court findings, and congressional and agency reports that establish the anti-competitive effects on both insurance agents and consumers of credit tying. These documents were submitted to your committee in connection with our national association's testimony last year.

In light of such overwhelming evidence of the long term negative consequences that could be expected from the unrestricted entry of banks into the insurance business, and in light of congressional action less than two years ago to explicitly limit the insurance authority of BHCs, we are deeply concerned about legislation now pending before your committee that proposes dramatic modifications in the traditional separation between banking and insurance.

Specifically, both the Financial Institutions Deregulation Act, and the more recently introduced Financial Services Competitive Equity Act provide explicit authority for bank holding company insurance sales and underwriting. While both bills contain provisions which acknowledge the potentially anti-competitive effects of credit tie-ins associated with bank insurance sales, neither bill deals with the problem in a way that ensures a competitive market, increased service, and other benefits to the consumer, or that justifies a departure from the existing historic constraints on bank insurance activities reaffirmed by the enactment of Title VI two years ago.

In connection with credit tying, coercion of debtor provisions may actually ratify and make easier to conceal the anti-competitive tie-in. Because the tie-in is intrinsic to a lender's authority to offer the insurance product, the ability to follow a series of required disclosures simply bestows on the practice a misleading legal seal of approval. Even though tying may have occurred - and may have been instigated by the ability to produce documents which purport to show it had not - coercion of debtor provisions remove any basis for establishing anti-competitive behavior.

Insurance agents, of course, realize that the reforms contained in these bills are proposed in a financial market context marked by extraordinary change. Technological innovations, the growth and success of non-depository financial institutions, mergers and acquisitions, and a bewildering array of financial service hybrids all undeniably have influenced the way financial services are organized, marketed, and regulated.

And these changes are the catalyst for a congressional review of federal laws and regulations that may lead ultimately to comprehensive reform. But at least two things must be said to put these market changes and proposed restructuring into perspective.

First, while much has changed over the past few years about banking, we must continue to appreciate what has not changed. Safety and soundness, the separation of banking and commerce, and a recognition of the special power associated with providing our economy's credit continue to define the fundamental features of banking. We ignore them at our peril.

Second, in the context of a federal system as unique and specialized as banking, it is not enough to look approvingly on the innovation of the marketplace or the legal ingenuity of our nation's largest banks. Congress must determine either that these changes are in the public's interest, or, if they are not, must set limits that are relevant to the day-to-day conduct of banking. In this regard, it is worth noting that when Congress established the BHC insurance restrictions contained in Title VI, it did so as a matter of federal banking policy intended to apply to every context. This was reaffirmed last week when, in connection with several applications by BHCs to engage through state banks under state law in broader insurance activities than the Act permits, the Federal Reserve Board's opinion was that the proposed bank acquisitions could not be approved under present law. In reaching this conclusion, the Board referred explicitly to Title VI.

The importance of congressional prerogative in determining changes and limits in banking law highlights the fundamental flaw in the approach to deregulation contained in the bills now before your committee. They attempt merely to ratify what is occurring in the market today. But much of the change in financial institutions and services today is the result of regulatory activisim and legal sleights-of-hand that stretch to the limit and sometimes break the outer boundaries of existing bank laws and regulations. Changes fueled by ingenious bank lawyers or impatient regulators may or may not serve the long-term public interest, and may or may not anticipate the changes Congress deems it appropriate to make.

We would argue that the case for the major deregulation of banking has not been persuasively made. Banks continue to be unique institutions performing a special service within our economy. The current system of regulation, and its public policy underpinnings continue to serve the public well. There is no evidence that major banking institutions have lost any market share to their near bank competitors. And finally, there is no evidence that the public would be deprived of access to services or the benefits of a competitive market should banks continue to operate within a legal and regulatory framework that recognizes the level of risk as the feature of financial services most important to consumers and properly the first concern of Congress.

In this connection, insurance today is highly competitive in terms of price, coverage, and service. This is not only statistically accurate in terms of steadily decreasing premium costs over time, but is readily apparent to anyone who has recently shopped for insurance coverages and sampled the competition that today defines the insurance market. Numerous outlets, ease of entry, and opportunity to apply entrepreneurial skills to achieve economic success are the hallmarks of today's insurance market, and every day bring to customers the tangible, real-life benefits of competition. The American Agency System is intrinsically competitive, and would be made less so by unrestricted bank entry.

On the other hand, in few places on earth is banking a strictly free enterprise activity. In this country, at least, it is highly regulated and endowed uniquely with a government franchise to accept deposits, extend commercial credit, benefit from certain tax and interest rate advantages, and rely on the protection of federal deposit insurance. This, combined with banks access to loan customers' privileged financial profiles and insurance expirations, gives banks an obvious and insurmountable competitive edge over unaffiliated insurance agents. Moreover, these unfair advantages place the consumer at the mercy of his credit requirements, forcing him to base a decision to purchase insurance on factors other than lower price, better service, or more complete coverage.

Insurance agents are independent-minded small business people who operate in a fiercely competitive insurance market. We value our independence, and our ability to offer consumers the kind of continuing service and advice necessary to providing adequate protection for their personal property and commercial enterprises. We believe that this independence and competition will be jeopardized by an ill-conceived restructuring of financial institutions, and appreciate your personal interest in this important matter.

I would be happy to answer any questions.

The CHAIRMAN. Mr. Kelly.

Mr. KELLY. I submitted an outline of my comments but in the interest of time I'll just go through some of my notes.

The CHAIRMAN. As I said before, your entire statement will be printed.

STATEMENT OF DAVID M. KELLY, PRESIDENT, UTAH ASSOCIATION OF LIFE UNDERWRITERS

Mr. KELLY. I am David M. Kelly, president of the Utah Association of Life Underwriters. I am here today to represent the 700 members of the Utah Association of Life Underwriters and to express our concern with Senate bill 2181 which will permit bank holding companies or their subsidiaries to market and/or underwrite insurance. In theory, deregulation is a fine idea, and our organization generally endorses free competition. However, life underwriters know that there is no way to compete fairly and evenly with the credit-granting powers of financial institutions when credit is marketed along with other products and services, such as insurance.

CREDIT IS LIFEBLOOD OF BUSINESS

By the passage of title VI of the Garn-St Germain Depository Institution Act of 1982, Congress reaffirmed the longstanding public policy of separating banking from insurance. The monopoly power of banks over demand deposits and local short-term credit has long provided the rationale to keep banks out of general commerce including insurance activities. This is the case because credit is the lifeblood of business—especially in a tight credit market. Expansion of banking into insurance presents the triple threat of undue concentration of economic power, decreased and unfair competition, and unlawful tying of bank credit to insurance sales.

While not always explicit, the pressure to purchase insurance may be a mere perception of the buyer that it would be to his advantage to make the joint purchases. This tie-in sale doesn't increase competition and improve the marketplace for the insurance consumer. Title VI, however, will allow consumers to purchase insurance which has the best terms, quality, and services, not due to a need to obtain, or a fear of losing a line of credit.

The experience of credit life insurance sold by banks in conjunction with consumer loans illustrates the tie-in sale. The Insurance Department of the State of Utah and other States have forced the reduction of premiums for this coverage to protect the consumer. Expansion of these sales to larger loans will not change anything.

Another unfair advantage that would be enjoyed by banks is access to confidential credit information of their bank customers. I reaffirm, unlike other services a bank may offer, insurance sales are uniquely vulnerable to direct or implied coercion because only insurance is required for a borrower to qualify for credit, and insurance coverages are almost always certified at the point of the loan transaction.

I am an agent that calls on business owners every week. Regardless of what laws and regulations we have to control the tie-in sale of the insurance-loan transaction, the practical thing will happen. If the business owner needs the loan, he will do whatever is necessary to obtain it. No matter how great a product I have to sell, or how great my service, the business owner will buy from the bank subsidiary when faced with the possibility of losing his business because of lack of credit. Could any agent ask his client to maintain his loyalty to him when faced with the possibility of jeopardizing his credit line?

IMPACT OF PROPOSED INJUNCTIVE RELIEF

I am not an attorney so I don't fully understand the proposed remedies for these tie-in sales. It is my feeling, however, that the provision in the bill relating to injunctive relief is no remedy at all. First, it defies reality to believe that a consumer or business person will jeopardize his/her line of credit to expose a tie-in sale. Second, injunctive relief is only prospective and would not apply after the fact. Thus, once a policy is purchased, nothing could be done.

Dual regulation of the various Government agencies will not solve the problem. Even though our State insurance department has rules against an improper inducement to make a sale of insurance, the agent as the injured party, would have no case unless the insured offered to testify against his lender. As I have previously mentioned, it is unlikely that this will ever happen. In our view, the best solution to the tie-in sales by banks of insurance can be found in current law or embodied in title VI. There are other regulatory problems that have been presented to your committee. As agents, we are affected by these problems, and the chaotic marketing environment that is created. We do not feel that regulation has evolved to the point that it can handle deregulation.

It is true that certain insurance companies have purchased banks and, as an agent, I am against this action. However, it is important to note that these banks were purchased because of the FDIC insurance in relation to their money market accounts offered through a brokerage house subsidiary. One of these companies, the Prudential, has openly supported legislation that, if enacted, would force it to divest itself of its bank. The Prudential and other insurance companies feel that the agent plays an indispensible role in helping consumers deal with their insurance needs, and the public is better served by the individual attention that agents provide. This relationship will not be the same if banks are allowed to sell insurance.

The consumer freedom of choice that currently exists would be a thing of the past when large depository institutions are able to combine the leverage of credit with the underwriting and marketing of insurance.

As Paul Volcker mentioned this morning, if the consumers cannot be benefited more by the bill in relation to the problems that the bill creates, then alternate choices should be sought until this can happen. Thank you.

[Complete statement follows:]

TESTIMONY

by

DAVID M. KELLY, CLU

representing

UTAH ASSOCIATION of LIFE UNDERWRITERS

January 16, 1984

I. All insurance producer groups have long been concerned with the anti-competitive effects associated with the combination of banking and insurance. Banks entering the insurance industry will not increase competition and improve the market place for the consumer. The experience of credit life insurance sold by banks in conjunction with consumer loans illustrates this point.

II. Banks will have an unfair advantage in the sale of Life Insurance for the following reasons:

   A. Credit tie-in (direct or implied). Consumers purchase insurance from banks to protect their source of credit. The rest of the Life Insurance market place is faced with the unsurmountable and unfair competitive barrier of the banks' control of credit.

   B. FDIC Insurance

C. Acess to confidental credit information about bank customers.

D. Impressions on the part of the bank customer that Life Insurance is part of the loan package. Unlike other services a bank may offer, insurance sales are uniquely vulnerable to direct or implied coercion because only insurance is required for a borrower to qualify for credit, and insurance coverages are almost always certified at the point of the loan transaction.

III. Regulatory Problems

A. Banks financial condition could be inpaired if insurance company became insolvent. Would FDIC insurance cover this contingency? Do state insurance guaranty funds cover bank deposits? Regulation has not yet evolved to the point that it can handle deregulation. The SEC (federal control), State Insurance Departments (state control), Financial Institutions Department (state control), and the Commerce Department (federal control), have not yet developed a coordinated regulatory approach to mixed industries.

B. The regulatory questions result in a chaotic marketing environment in which we must work. Until these problems can be solved; a moritorium on all three industry branches; Insurance Companies, Banks, and Brokerage firms from cross purchases should be declared until a balanced and sensible policy is developed.

IV. Marketing Life Insurance with the agent-agency system will be disrupted.

  A. If banks through their holding company sell insurance there will be a trend toward fewer insurance agents, agencies, and companies. This will not enhance competition and the consumers will suffer, not to mention agents, agency employees, and insurance company employees.

  B. We of the insurance industry feel that the agent plays an indispensible role in helping consumers deal with their insurance needs, and the public is best served by the individual attention that agents provide. We feel that this relationship will not be the same if the banking industry is allowed to enter the insurance business.

V. The Life Insurance agents of Utah support Title VI of the Garn-St. Germain Act. The provision relating to injunctive relief as contained in the present proposal amounts to a non-remedy because it defies reality to believe that a consumer or business person will jeopardize his/her line of credit to expose a tie-in sale. Injunctive relief is only prospective and would not apply after the fact. There are no adequate antitrust remedies which address the dangers of voluntary tie-ins whereby a potential loan applicant might voluntarily place his insuranace business with a bank-affiliated insurer in the hope of improving his chances to obtain credit from a bank on a favorable term; or at all.

The **Chairman**. Thank you very much, Mr. Kelly. As Ken well knows from a lot of discussions last year, title VI stayed in the bill because of my efforts to do so. So I suppose the question then occurs that if you put that provision in it and definitely make a separation, why do you have a provision this year? Ken and Byron and others know the answer to that question. It's an issue that you can't hide. I said last year that it would be up again and it will be. So rather than waiting for somebody to slap an amendment on and markup or wait until we get to the floor, you might as well address it up front.

You can't hide certain issues. You can't put them under the table. The people who weren't willing to agree with you aren't willing to surrender because we beat them last year. I might as well put it in and have it there and up front. A lot of issues are that way. That is what I have tried to explain several times today.

Several of the issues are there today because they are issues. You can't hide them and put a hat over them because the other side, the opposition, will make certain they are brought up. I think it makes more sense to put the issues in the bill to begin with so they are not hidden and everybody has the opportunity to express their viewpoint rather than have it done sneakily, as is often done in the Congress. That's the major reason it is back in. It's to focus on the issue rather than to be a final solution.

In addition, I am pleased with your testimony and particularly the last part of it. You addressed both sides of the issue. You said you weren't going to favor the insurance companies getting into the banking business.

Mr. **Osborne**. We don't support that either.

The **Chairman**. That's the kind of thing I can understand. The thing that frustrates me about the securities testimony is I have never gotten that kind of thing. "We don't want banks in but we are not willing to get out." I appreciate that kind of candor because if it is fair to say that banks can't get involved in the insurance business, then it is fair to say that the insurance business cannot get involved in the banking business.

Mr. **Osborne**. Speaking for the insurance, we support that wholeheartedly.

The **Chairman**. I appreciate the balanced nature of your testimony. To me that is consistent. Whatever the securities people want to say I can accept and understand if they would also say if it isn't fair for banks to get into securities than it isn't fair for us to get involved in their business.

I appreciate your comments and your personal opinions, that you are opposed.

Mr. **Osborne**. I don't know one insurance man that owns a bank in the State of Utah.

The **Chairman**. There are some. But we are talking about large companies owning other types of financial institutions.

Senator **Lautenberg**. I think what our friends are saying is that if the dog bites man, as far as they are concerned, it's fair for the man to bite the dog.

The **Chairman**. I agree.

Senator **Lautenberg**. Though I don't want to change the friendliness of this exchange——

The CHAIRMAN. Then don't.

Senator LAUTENBERG. I can understand that you wouldn't mind keeping the insurance companies out. How many banks do you own?

Mr. OSBORNE. Very few.

The CHAIRMAN. I can testify he doesn't own any banks.

Thank you again.

The next panel will be Wallace Jacobsen, president, Wally Jacobsen Construction Co., Inc.; past president and member of the executive committee, Homebuilders Association of Utah. And Russell K. Booth, agent, Commerce Properties, Salt Lake City; president, Utah Association of Realtors.

We appreciate both of you being here and certainly because you are last doesn't mean you are least. But we are pleased you are here and Wally, if you'd like to begin.

[EDITORIAL COMMENT: Whereupon, Mr. Jacobsen's statement will be inserted into the record with the following changes: (1) The third sentence of the first paragraph on the first page should read: "While I speak on my own behalf, and not for any organization, my testimony is representative of the view of the home builders in Utah, and . . ." (2) The second sentence of the second paragraph on page 2 should read: "There are several thousand home builders in Utah." (3) The last sentence on page 6 should be deleted.]

[The complete statement follows:]

STATEMENT OF WALLACE JACOBSEN, PRESIDENT, WALLY JACOBSEN CONSTRUCTION COMPANY; PAST PRESIDENT AND MEMBER OF THE EXECUTIVE COMMITTEE, HOMEBUILDERS ASSOCITATION OF UTAH

TESTIMONY BEFORE SENATOR JAKE GARN

UTAH HEARINGS ON S. 2181

SENATOR GARN, I AM WALLACE V. JACOBSON, A HOME BUILDER FROM SALT LAKE CITY, UTAH. I AM PLEASED TO HAVE THE OPPORTUNITY TO DISCUSS WITH YOU YOUR LEGISLATION, S.2181, AND OTHER INITIATIVES TO DEREGULATE THE BANKING AND FINANCIAL SERVICES INDUSTRY. WHILE I SPEAK ON MY OWN BEHALF, AND NOT FOR ANY ORGANIZATION, MY TESTIMONY IS REPRESENTATIVE OF THE VIEW OF THE MORE THAN 8,500 HOME BUILDERS IN UTAH, AND, I BELIEVE, HOME BUILDERS THROUGHOUT THE NATION.

I COMMEND YOU FOR YOUR EFFORTS TO DEVELOP AN ORDERLY APPROACH FOR THE GROWTH OF THE RAPIDLY CHANGING FINANCIAL SERVICES SECTOR OF OUR NATION. YOUR LEADERSHIP IN INTRODUCING LEGISLATION AND HOLDING HEARINGS IN THE FIELD DEMONSTRATES YOUR COMMITMENT IN DEVELOPING WORKABLE LEGISLATION.

AS A HOME BUILDER, I MUST FRANKLY SAY THAT I'M CONCERNED THAT THE LEGISLATIVE PROPOSALS WILL ONLY ACCELERATE THE TREND TOWARDS A CONGLOMERATION OF FINANCIAL POWER IN THE HANDS OF A FEW LARGE FINANCIAL INSTITUTIONS AND FURTHER REDUCE OUR NATIONAL COMMITMENT TO AFFORDABLE HOUSING FOR ALL AMERICANS. THE CURRENT SYSTEM HAS PRODUCED THE BEST HOUSED NATION IN THE WORLD. IT HAS DONE SO BECAUSE THE NATION HAS PLACED A PRIORITY ON HOME OWNERSHIP, IN PART THROUGH THE ESTABLISHMENT OF THRIFT INSTITUTIONS DEDICATED TO MEETING HOME FINANCE NEEDS. REORGANIZATION OF THE SYSTEM SHOULD NOT BE ALLOWED TO THREATEN THE NATIONAL COMMITMENT TO HOME OWNERSHIP. POTENTIALLY, THE AMERICAN HOME OWNER COULD BE THE ULTIMATE LOSER IF POLICY CHANGES DO NOT FOSTER HOME OWNERSHIP WHICH IS THE CORNERSTONE OF OUR DEMOCRATIC SOCIETY.

DRAMATIC CHANGES ARE OCCURING IN THE HOME BUILDING INDUSTRY. LARGE VOLUME

AND SMALL CUSTOM BUILDERS WILL PROBABLY FACE THE FEWEST PROBLEMS COMPETING IN THE MARKET IN THE 1980'S. MIDDLE SIZED BUILDERS (FROM 25 TO 250 UNITS) ARE UNDER SEVERE PRESSURE TO REMAIN COMPETITIVE BECAUSE OF PROBLEMS WITH ACCESS TO AFFORDABLE MORTGAGE CREDIT.

IN THIS REGARD, UTAH IS FAIRLY TYPICAL OF THE REST OF THE NATION. THERE ARE ~~APPROXIMATELY 8,500~~ several thousand HOME BUILDERS IN UTAH. MOST ARE SMALL FIRMS OPERATING IN ONE OR TWO LOCALITIES. THE AVERAGE HOME BUILDER IN UTAH BUILDS 5-10 HOMES PER YEAR. A LARGE BUILDER WOULD BUILD 100-250 HOMES, A SMALL BUILDER WOULD BUILD 3-4 HOMES. THIS SITUATION PRODUCES A HIGHLY COMPETITIVE ENVIRONMENT.

THE FINANCIAL SERVICES INDUSTRY IS ALSO UNDERGOING DRAMATIC CHANGES THROUGH DEREGULATION AND INNOVATION. IF UTAH, WHOSE RESIDENTS PLACE GREAT IMPORTANCE ON HOME OWNERSHIP, IS TO BENEFIT, THESE CHANGES SHOULD LEAD TO STRENGTHENING THE MORTGAGE FINANCE SYSTEM. THE HOME BUYER SHOULD HAVE ACCESS TO MORTGAGE MONEY AT RATES AND ON TERMS THAT HE OR SHE CAN AFFORD. THE SMALL BUSINESSMAN, SUCH AS THE HOME BUILDER, SHOULD HAVE ACCESS TO CREDIT AT COMPETITIVE RATES.

SEVERAL GENERAL PRINCIPLES NEED TO BE FOLLOWED. FIRST, LEGISLATION SHOULD FOSTER COMPETITION AND SECOND, IT SHOULD NOT UNFAIRLY DISADVANTAGE ANY ONE PLAYER OR GROUP OF PLAYERS IN THE COMPETITIVE ARENA.

THE CURRENT SITUATION IN WHICH BANKING INSTITUTIONS ARE PROHIBITED FROM ENGAGING IN CERTAIN FINANCIAL ACTIVITIES WHILE NON-BANKING INSTITUTIONS, SUCH AS BROKERAGE FIRMS AND OTHER SOURCES OF CREDIT, ARE PERMITTED TO ENGAGE IN TRADITIONAL BANKING ACTIVITIES CLEARLY IS CREATING AN UNFAIR COMPETITIVE SITUATION. IN ADDITION, CONSUMERS ARE CONFUSED ABOUT DISTINCTIONS BETWEEN BANKS, SAVINGS & LOANS, AND BROKERAGE FIRMS AS EACH BEGINS TO MARKET SIMILAR FINANCIAL PRODUCTS.

HOWEVER, IN SEEKING TO REMEDY THIS SITUATION, LEGISLATION SHOULD NOT FOSTER THE EMERGENCE OF NEW ANTI-COMPETITIVE FORCES.

THE CONTINUING CONSOLIDATION OF THE FINANCIAL INDUSTRY, ACCOMPLISHED THROUGH THE GROWTH OF BRANCH BANKS AND MULTI-BANK HOLDING COMPANIES, FORCES SMALL BUSINESS TO COMPETE AGAINST LARGE CORPORATIONS, THE FEDERAL GOVERNMENT AND FOREIGN COUNTRIES IN THEIR QUEST FOR CAPITAL. AS A SMALL BUSINESS MAN, THE UTAH HOME BUILDER DEPENDS HEAVILY ON COMMUNITY-BASED LENDERS FOR PROJECT FINANCING. THE REVOLUTION IN THE FINANCIAL SERVICE INDUSTRY THREATENS TO REPLACE THE NEIGHBORHOOD BANK WITH AN AUTOMATIC TELLER MACHINE.

WHAT WILL HAPPEN WHEN THE SMALL LOCALLY BASED INSTITUTIONS HAVE DISAPPEARED AND THEIR DEPOSITS HAVE BEEN TRANSFERRED TO FINANCIAL CENTERS SUCH AS NEW YORK? WILL A LOAN REQUEST BY A YOUNG BUILDER WANTING TO BUILD TWO HOUSES OR A BUSINESSMAN TRYING TO START A LOCAL CLOTHING STORE BE EVALUATED UNDER NATIONAL BANK STANDARDS SET IN NEW YORK CITY? OR WILL THE NEW YORK BANK REFUSE TO CONSIDER SMALL LOANS AS TOO EXPENSIVE TO PROCESS? THE REALIZATION OF THIS VISION OF THE FUTURE WILL NOT SERVE US WELL.

THE THRUST OF DEREGULATION HAS BEEN UPON HOW BANKS AND THRIFTS GET CAPITAL, NOT HOW THEY USE THE FUNDS. THE LARGE FINANCIAL INSTITUTIONS ARE DEVELOPING EVER MORE EFFICIENT WAYS TO COLLECT FUNDS THROUGHOUT THE NATION. THEY SAY NOTHING ABOUT HOW, OR WHERE, THEY PLAN TO LEND THOSE FUNDS. THE BANKS ARE RIGHTFULLY CONCERNED ABOUT COMPETITION FROM NON-DEPOSITORY INSTITUTIONS, BUT ALLOWING THEM TO ABANDON LOCAL TIES IS NOT A SOLUTION. FINANCIAL INSTITUTIONS EXIST FIRST TO PROVIDE FOR THE CREDIT NEEDS OF THE COMMUNITIES FROM WHICH THEY DRAW DEPOSITS.

THE AUTHORITY OF BANKS TO PARTICIPATE IN REAL ESTATE DEVELOPMENT, FINANCE, AND SALES WOULD PROVIDE ENORMOUS POWER IN FINANCIAL INSTITUTIONS. I AM PLEASED TO NOTE THAT YOUR BILL EXPRESSLY PRECLUDES BANK HOLDING COMPANIES ENGAGED IN REAL ESTATE ACTIVITIES FROM OPERATING CONSTRUCTION COMPANIES. HOWEVER, THE PARTICIPATION OF BANK HOLDING COMPANIES IN REAL ESTATE ACTIVITIES HAS SEVERAL ANTI-COMPETITIVE DANGERS.

FIRST, DIRECT COMPETITION BETWEEN FINANCIAL INSTITUTIONS, INDEPENDENT BUILDERS, AND DEVELOPERS IS UNEQUAL AND UNFAIR. THE FINANCIAL INSTITUTIONS HAVE THE INHERENT ABILITY TO SECURE SITE FINANCING AT MORE FAVORABLE TERMS THAN ARE AVAILABLE TO INDEPENDENT COMPANIES. THE FINANCIAL INSTITUTIONS CAN EXTEND MORE FAVORABLE CONSTRUCTION AND MORTGAGE FINANCING TO THEIR PROJECTS. THEY CAN PROCESS THEIR OWN HOME BUYING CLIENTS FASTER. THEY DO NOT HAVE TO SHOW THE SAME PROFIT AS AN INDEPENDENT IN ORDER TO STAY IN BUSINESS BECAUSE THEY WILL NOT FORECLOSE ON THEIR OWN PROJECTS AND CAN SUBSIDIZE THEIR DEVELPOPMENT OPERATIONS WHEN NECESSARY FROM THEIR PARENT OPERATIONS.

A SECOND PROBLEM IS ANTI-COMPETITIVE PRACTICES BY FINANCIAL INSTITUTIONS. NORMALLY, THIS TAKES THE FORM OF PREFERENTIAL LENDING. THE FINANCIAL INSTITUTION OFFERS BELOW MARKET CONSTRUCTION AND MORTGAGE FINANCING ON PROJECTS IN WHICH IT HAS AN INTEREST. SOME S & L'S HAVE EVEN REFUSED TO EXTEND LOANS EXCEPT ON PROJECTS IN WHICH THEY HAVE AN INTEREST, EFFECTIVELY CUTTING THEIR BUILDING COMPETITORS OFF FROM THEIR TRADITIONAL SOURCE OF FINANCING. A FINAL ABUSE IS THE TYING ARRANGEMENT. A LOAN CUSTOMER MAY BE OBLIGED TO OBTAIN ANOTHER SERVICE SUCH AS A BUSINESS CHECKING ACCOUNT IN ORDER TO OBTAIN CONSTRUCTION OR PERMANENT FINANCING.

A THIRD PROBLEM IS THE LONG-TERM POSSIBILITY OF FINANCIAL INSTITUTIONS SETTING UP COMPANIES THAT CONTROL VIRTUALLY ALL ASPECTS OF THE REAL ESTATE DEVELOPMENT BUSINESS. THIS VERTICAL INTEGRATION WOULD INVOLVE THE SAME COMPANY BUYING LAND, DEVELOPING IT, BUILDING, MARKETING, FINANCING ACQUISITION BY ITS CUSTOMERS, AND INSURING MORTGAGES. IN ADDITION TO THEIR REAL ESTATE DEVELOPMENT POWERS, FEDERAL THRIFTS' SERVICE CORPORATIONS ALREADY CAN ACQUIRE AND RENT COMMERCIAL REAL ESTATE, RENOVATE COMMERCIAL REAL ESTATE, PROVIDE PROPERTY MANAGEMENT SERVICES, AND PROVIDE REAL ESTATE BROKERAGE SERVICE FOR THEIR OWN PROJECTS. THIS TREND WILL ELIMINATE COMPETITION AND CONCENTRATE CONTROL OF DEVELOPMENT IN FEWER, LARGER COMPANIES CONTROLLED BY BANKS AND

THRIFTS. THOSE LARGE INSTITUTIONS WOULD THEN BE FREER TO RAISE PRICES AND TO DESTROY PRICE COMPETITION.

TO PERMIT BANK HOLDING COMPANIES TO SET UP SUBSIDIARIES THAT CAN INVEST DIRECTLY IN REAL ESTATE IS A SHORT SIGHTED CHANGE THAT TRADES OFF THE LONG-TERM INTEREST OF THE FREE MARKET SYSTEM FOR POSSIBLE SHORT-TERM BENEFITS TO FINANCIAL INSTITUTIONS AND VERY FEW CONSUMERS. USING FINANCIAL LEVERAGE, THE BANK HOLDING COMPANY WILL BE ABLE TO ARRANGE PREFERENTAIL FINANCING TO THE CUSTOMERS OF ITS DEVELOPMENT SUBSIDIARY. THEY CAN UNDERCUT THE SMALL BUILDER OR DEVELOPER WHO MUST OBTAIN CONSTRUCTION FINANCING AT MARKET RATES AND WHOSE CUSTOMERS MUST GET PERMANENT FINANCING AT MARKET RATES. WE VIEW LARGE BANKS AS A GREATER THREAT TO COMPETITION THAN THRIFTS BECAUSE OF THEIR PHENOMENAL ASSETS AND REMOTENESS FROM LOCAL COMMUNITIES.

BANKS AND THRIFTS ENGAGING IN REAL ESTATE DEVELOPMENT WILL ACTUALLY HARM THE COMPETITIVE SYSTEM. THEIR SUCCESS WILL BE AT THE COST OF THE SMALL AND MEDIUM-SIZED BUILDER. THEY CANNOT BYPASS THE BANKS AND THRIFTS AS CAN THE LARGER BUILDERS. ESPECIALLY IN SMALL MARKETS, THE SMALLER BUILDER IS ALMOST WHOLLY DEPENDENT ON TRADITIONAL LENDERS. HE CANNOT COMPETE WITH THEM.

THE SUBSIDIARY IS NOT AN ANSWER TO THE QUESTION OF RISK AND FAIR DEALING. RULES WRITTEN REQUIRING ARMS-LENGTH TRANSACTIONS WILL NOT IN FACT PRECLUDE PREFERENTIAL TREATMENT OF A SUBSIDIARY BY ITS PARENT CORPORATION OR AFFILIATES. THE RISK TO THE PARENT MAY BE REDUCED BUT WILL NOT BE ELIMINATED BY THE USE OF A SUBSIDIARY.

THE DIVISION BETWEEN COMMERCE AND FINANCE SHOULD BE MAINTAINED IN THE CASE OF REAL ESTATE DEVELOPMENT.

I WOULD URGE YOU TO FOCUS UPON INNOVATIVE APPROACHES OF PROVIDING HOME-OWNERS WITH ACCESS TO MORTGAGE CAPITAL. YOUR LEADERSHIP IN PROMOTING LEGISLATION TO EXPAND ACCESS FOR CONVENTIONAL MORTGAGE-BACKED SECURITIES IS APPRECIATED. BUILDERS ARE DEVELOPING INNOVATIVE FINANCING OF THEIR OWN SUCH AS BUILDER BONDS WHICH MUST BE RETAINED. PENSION FUND INVESTMENT IN MORTGAGES

SHOULD BE ENCOURAGED.

IN CONCLUSION, THE DEREGULATION LEGISLATION ACCELERATES THE TREND TOWARD A NATIONAL BANKING SYSTEM. INSTEAD OF LOCAL BANKS, THE LEGISLATION ENCOURAGES LARGE NATIONWIDE BANKING SYSTEMS. THESE NATIONWIDE BANKING SYSTEMS COULD VERY WELL CREATE A SYSTEM OF NATIONWIDE REAL ESTATE AND HOME BUILDING. THE SMALL INDIVIDUAL ENTREPRENEUR, WHO IS CHARACTERISTIC OF TODAY'S HOME BUILDING, COULD BECOME AN ENDANGERED SPECIES.

THANK YOU FOR THE OPPORTUNITY TO TESTIFY. I WOULD BE HAPPY TO ANSWER ANY QUESTION WHICH YOU MAY HAVE.

The CHAIRMAN. Thank you, Mr. Jacobsen.

STATEMENT OF RUSSELL K. BOOTH, PRESIDENT, UTAH ASSOCIATION OF REALTORS

Mr. BOOTH. Mr. Chairman, my name is Russell K. Booth and I am the current president of the Utah Association of Realtors. I am here on behalf of the 4,200 members of the Utah Association of Realtors, who are involved in every facet of real estate. I would like to thank you for the opportunity to appear before the committee to comment on pending financial institutions deregulation legislation.

Having been here all day I am aware of the amount of testimony you have received and I will abbreviate the written statement, knowing it will be in the final record.

We believe in and accept the general philosophy of Government deregulation, and that it is generally a good practice to move as many decisions as possible closer to the marketplace.

The three main points of our testimony are: One, foremost, we believe that it is necessary to promote the safety, soundness and competitiveness of federally insured banking institutions. Two, conflicts of interest need to be minimized, where they do exist. Situations or laws that foster such problems, should not be created. Three, we support prevention of the concentration of massive economic resources in the hands of a few.

The potential danger of high-risk nonbanking activities such as real estate investment and development are relevant to the public's perception of the safety and soundness of the depository institution itself.

FDIC USED AS A MEANS TO ATTRACT DEPOSITORS

When a business needs capital, it must borrow these funds. Financial institutions borrow funds from depositors. These funds are in large part available because of Federal deposit insurance. A cursory review of current advertisements for the money market deposit accounts underscores the important advantage of Federal deposit insurance as a means of attracting depositors.

Access to credit from Federal regulatory agencies such as advances from the Federal Home Loan Bank Board and the Federal

Reserve's discount window provide financial institutions an important tool available in other businesses. These federally supported benefits for depository institutions are very important to assure this Nation of a stable and secure system of depository institutions. However, these benefits put them in a special class. Any changes which make these institutions competitors, rather than resources for the commerce of this Nation, should take into account these benefits and the likelihood that they would provide unequal and unfair competition.

The tax treatment of federally chartered financial institutions also provides strong Federal tax support that regular businesses do not enjoy. These are enumerated in our written statement.

The important objectivity and impartiality of lending institutions and their personnel in credit lending and real estate project lending will be seriously eroded or destroyed if the financial institution is a daily competitor of the developer or broker seeking their help. The lending institutions' integrity to their customers will be at risk.

ADVANTAGES OF DEREGULATION OF DEPOSITORY INSTITUTION HOLDING COMPANIES

The Utah Association of Realtors advises against the deregulation of depository institution holding companies with regard to authorizing new activities which would irrevocably change the marketplace. While some entities could possibly compete with subsidiaries of federally insured depository institutions, the brokerage of real estate and other real estate services could not. We are concerned about the ability of the small independent businessman to compete on the, often quoted today, level playing field. A depository institution holding company subsidiary decidedly has a clear competitive advantage over a local real estate broker, property manager, appraiser, developer or homebuilder that does not have a special relationship with a federally supported financial institution. Access to credit, after all, is the crux of our industry. For this reason alone, bank holding company subsidiaries and service corporations should be restricted from activities that could dominate.

The Utah Association of Realtors does not agree with those who argue that the separate affiliate structure alleviates anticompetitive and safety and soundness concerns. Although legal separation of parts of the holding company may be desirable to assist appropriate functional regulation and to help contain the elements of risk, and conflicts of interest, it cannot prevent them. The national tendency will be toward the joint offering of a variety of products linked together in a significant way. The combination of banking and real estate brokerage in one holding company makes it more likely that these products will be puchased in the same place, and inducements to purchase one service packaged with another offered at an enticing price are natural. There can be no doubt that opportunities for tying, whether blatant or subtle, will continue to exist if depository institutions are permitted to offer real estate brokerage and other services together with conventional banking products.

CASES FROM NEBRASKA AND IOWA PROVIDE FOUNDATION FOR OPPOSITION

The potential for abuse is not limited to outright ownership. The National Association of Realtors has been writing the Federal Home Loan Bank Board about a Federal savings and loan in Lincoln, Nebr. that, without seeking prior FHLBB approval, entered into a contractual arrangement with a real estate brokerage firm. I have attached copies of Nebraska newspaper advertisements that will no doubt leave consumers in Nebraska with the distinct impression that First Federal Savings and Loan Lincoln has entered the third-party brokerage business. Further, these ads clearly imply that preferential lending rates are available for consumers doing business with their realtors affiliate if the consumer is interested in a package deal. Let us not forget that First Federal was able to acquire the funds that will be used to finance sales of the realtor affiliate through the use of its Federal Savings & Loan Insurance Corp. insurance sticker. That is, depositors chose to invest their funds with an entity that provides Federal Deposit Insurance. I would also like to provide some cases supplied to us by the Iowa Association of Realtors. Iowa's State institutions have been able to broker real estate for years, and these problems have arisen:

> A broker in a western Iowa metropolitan board made several visits to southwest Iowa to assist one of his salespersons in listing a property. The client wanted to list, but informed the salesperson that a banker in the community was also licensed, and the banker had informed the prospective client that financing would not be available if they listed with someone other than him.
>
> A salesperson with a firm in a western Iowa metropolitan board took a client into a savings and loan for a loan application. A vice president of the S&L called the buyer later in the same day and said that their trust department had some properties to show them.
>
> A Waterloo realtor had a house listed for several months. The sellers were several months behind in payments and could not come up with the money. While the listing was still in effect, the S&L who held the mortgage called on the sellers and said they were going to foreclose. However, they said they would give them an additional 3 months if they would list the property with them. The listing firm, not wanting to place the sellers in jeopardy, released them from the listing.

The cases from Iowa and Nebraska provide a foundation for our opposition and we believe that they are indicative of the types of future problems that will be created by the entry into real estate brokerage activities by federally insured depository institutions.

In Utah the Housing Finance Agency has issued submarket interest rate mortgage funds for low-income buyers of homes. The supply has been smaller than the demand. It is reported that lenders utilized a large amount of their allocated commitments nearly exclusively for their own, new home inventory and for their foreclosed property inventory, and gave preferential treatment to their own subsidiaries, joint venture partners, employees, and relatives. If this deregulation legislation were implemented, the potential for the above referenced abuses would be greatly magnified.

A large local federally insured savings and loan recently competed with other buyers, and purchased a series of former service stations and have, one by one, developed them into, or sold them for, more profitable uses. They competed in the open marketplace, using the advantages of federally borrowed submarket interest rate funds. Again, when economic resources and the power over them are too narrowly concentrated, abuses unintentional or otherwise may occur more easily.

In summary we ask this committee to consider the long-range impact on the availability of credit to individuals and businesses of all sizes and kinds in all sections of the country—in the small towns and rural areas as well as the financial centers of our country.

We are concerned that presumed efficiency and deregulation for their own sakes could negate the hard earned results of our existing regulatory framework.

We thank you again for the opportunity of providing this testimony and assure you of our willingness of help and any way possible throughout this legislative process.

[The complete statement follows:]

REALTOR®

UTAH ASSOCIATION OF REALTORS®

[illegible] South Main Street Suite #211
Salt Lake City, Utah 84115
Phone [illegible]

January 16, 1984

SENATE BANKING COMMITTEE HEARING - TESTIMONY - BANKING DEREGULATION

MR. CHAIRMAN, MY NAME IS RUSSELL K. BOOTH AND I AM THE CURRENT PRESIDENT OF THE UTAH ASSOCIATION OF REALTORS®. I AM HERE ON BEHALF OF THE 4,200 MEMBERS OF THE UTAH ASSOCIATION OF REALTORS®, WHO ARE INVOLVED IN EVERY FACET OF REAL ESTATE. I WOULD LIKE TO THANK YOU FOR THE OPPORTUNITY TO APPEAR BEFORE THE COMMITTEE TO COMMENT ON PENDING FINANCIAL INSTITUTIONS DEREGULATION LEGISLATION.

WE BELIEVE IN AND ACCEPT THE GENERAL PHILOSOPHY OF GOVERNMENT DEREGULATION, AND THAT IT IS GENERALLY A GOOD PRACTICE TO MOVE AS MANY DECISIONS AS POSSIBLE CLOSER TO THE MARKET PLACE. IN REGARD TO THE PROPOSED FINANCIAL INSTITUTIONS DEREGULATION LEGISLATION, THIS NEEDS TO BE DONE WITHIN LIMITATIONS TO NOT ONLY MAXIMIZE THE FINANCIAL STABILITY OF OUR DEPOSITORY INSTITUTIONS, BUT TO ALSO PREVENT UNFAIR COMPETITION. WE NEED TO PRESERVE THE LAW AND TRADITIONS OF THIS COUNTRY THAT RECOGNIZE A VALID SEPARATION OF BANKING AND COMMERCE.

WE BELIEVE IT IS A FAIR AND NECESSARY QUESTION TO ASK--WHEN DEREGULATION SEEMS TO BE THE CURRENT FASHION, WHAT WILL BE ACHIEVED BY MAINTAINING THE TRADITIONAL DISTINCTIONS BETWEEN BANKING AND OTHER TYPES OF FINANCIAL ENDEAVORS?

THE THREE MAIN POINTS OF OUR TESTIMONY ARE:

I. FOREMOST, WE BELIEVE THAT IT IS NECESSARY TO PROMOTE THE SAFETY, SOUNDNESS AND COMPETITIVENESS OF FEDERALLY INSURED BANKING INSTITUTIONS;

II. CONFLICTS OF INTEREST NEED TO BE MINIMIZED, WHERE THEY DO EXIST. SITUATIONS OR LAWS THAT FOSTER SUCH PROBLEMS, SHOULD NOT BE CREATED;

III. WE SUPPORT PREVENTION OF THE CONCENTRATION OF MASSIVE ECONOMIC RESOURCES IN THE HANDS OF A FEW.

I. FEDERALLY INSURED BANKING INSTITUTIONS

A. THE POTENTIAL DANGER OF HIGH RISK NON-BANKING ACTIVITIES SUCH AS REAL ESTATE INVESTMENT AND DEVELOPMENT ARE RELEVANT TO THE PUBLIC'S PERCEPTION OF THE SAFETY AND SOUNDNESS OF THE DEPOSITORY INSTITUTION ITSELF. THIS IS SO BECAUSE OF THE INEVITABLE LINKING OF A BANK'S REGULATION TO THAT OF ITS AFFILIATES, AS THE HOLDING COMPANIES THEMSELVES, THE SECURITIES MARKETS AND THE GENERAL PUBLIC LOOK UPON THE HOLDING COMPANY AND THEIR SUBSIDIARIES AS ONE CONSOLIDATED CORPORATION.

WHEN A BUSINESS NEEDS CAPITAL, IT MUST BORROW THESE FUNDS. FINANCIAL INSTITUTIONS BORROW FUNDS FROM DEPOSITORS. THESE FUNDS ARE IN LARGE PART AVAILABLE BECAUSE OF FEDERAL DEPOSIT INSURANCE. A CURSORY REVIEW OF CURRENT ADVERTISEMENTS FOR THE MONEY MARKET DEPOSIT ACCOUNTS UNDERSCORES THE IMPORTANT ADVANTAGE OF FEDERAL DEPOSIT INSURANCE AS A MEANS OF ATTRACTING DEPOSITORS.

B. ACCESS TO SPECIAL CREDIT

ACCESS TO CREDIT FROM FEDERAL REGULATORY AGENCIES SUCH AS ADVANCES FROM THE FEDERAL HOME LOAN BANK BOARD AND THE FEDERAL RESERVE'S DISCOUNT WINDOW PROVIDE FINANCIAL INSTITUTIONS AN IMPORTANT TOOL NOT AVAILABLE TO OTHER BUSINESSES! THESE FEDERALLY SUPPORTED BENEFITS FOR DEPOSITORY INSTITUTIONS ARE VERY IMPORTANT TO ASSURE THIS NATION OF A STABLE AND SECURE SYSTEM OF DEPOSITORY INSTITUTIONS. HOWEVER, THESE BENEFITS PUT THEM IN A SPECIAL CLASS. ANY CHANGES WHICH MAKE THESE INSTITUTIONS COMPETITORS, RATHER THAN RESOURCES FOR THE COMMERCE OF THIS NATION, SHOULD TAKE INTO ACCOUNT THESE BENEFITS AND THE LIKELIHOOD THAT THEY WOULD PROVIDE UNEQUAL AND UNFAIR COMPETITION.

C. FAVORABLE TAX TREATMENT

THE TAX TREATMENT OF FEDERALLY CHARTERED FINANCIAL INSTITUTIONS ALSO PROVIDES STRONG FEDERAL TAX SUPPORT THAT REGULAR BUSINESSES DO NOT ENJOY. THE BAD DEBT RESERVE ENABLES BANKS AND THRIFT INSTITUTIONS TO DEDUCT ADDITIONS TO BAD DEBT RESERVES OVER AND ABOVE ACTUAL LOAN LOSSES. BANKS CAN DEDUCT INTEREST ON OBLIGATIONS INCURRED TO PURCHASE TAX-EXEMPT SECURITIES, SOMETHING OTHER TAXPAYERS CANNOT DO. BANKS ALSO PAY LITTLE OR NO TAX ON FOREIGN ACTIVITIES. OTHER PREFERENTIAL TAX TREATMENT INCLUDES SPECIAL RULES FOR LOSS CARRYOVERS AND CARRYBACKS, EXEMPTIONS FROM RESTRICTION ON COMMODITY TAX STRADDLES, AND SPECIAL RULES FOR LOAN FORECLOSURES.

D. THE IMPORTANT OBJECTIVITY AND IMPARTIALITY OF LENDING INSTITUTIONS AND THEIR PERSONNEL IN CREDIT LENDING AND REAL ESTATE PROJECT LENDING WILL BE SERIOUSLY ERODED OR DESTROYED IF THE FINANCIAL INSTITUTION IS A DAILY COMPETITOR OF THE DEVELOPER OR BROKER SEEKING THEIR HELP. THE LENDING INSTITUTIONS INTEGRITY TO THEIR CUSTOMERS WILL BE AT RISK.

II. CONFLICTS OF INTEREST

A. COMPETITION WITH FINANCIAL SERVICE INDUSTRY REGULATION OF HOLDING COMPANIES.

THE UTAH ASSOCIATION OF REALTORS® ADVISES AGAINST THE DEREGULATION OF DEPOSITORY INSTITUTION HOLDING COMPANIES WITH REGARD TO AUTHORIZING NEW ACTIVITIES WHICH WOULD IRREVOCABLY CHANGE THE MARKETPLACE. WHILE SOME ENTITIES COULD POSSIBLY COMPETE WITH SUBSIDIARIES OF FEDERALLY INSURED DEPOSITORY INSTITUTIONS, THE BROKERAGE OF REAL ESTATE AND OTHER REAL ESTATE SERVICES COULD NOT. WE ARE CONCERNED ABOUT THE ABILITY OF THE SMALL INDEPENDENT BUSINESSMAN TO COMPETE ON A LEVEL PLAYING

FIELD. A DEPOSITORY INSTITUTION HOLDING COMPANY SUBSIDIARY DECIDEDLY HAS A CLEAR COMPETITIVE ADVANTAGE OVER A LOCAL REAL ESTATE BROKER, PROPERTY MANAGER, APPRAISER, DEVELOPER OR HOMEBUILDER THAT DOES NOT HAVE A SPECIAL RELATIONSHIP WITH A FEDERALLY SUPPORTED FINANCIAL INSTITUTION. ACCESS TO CREDIT, AFTER ALL, IS THE CRUX OF OUR INDUSTRY. FOR THIS REASON ALONE, BANK HOLDING COMPANY SUBSIDIARIES AND SERVICE CORPORATIONS SHOULD BE RESTRICTED FROM ACTIVITIES THAT COULD DOMINATE.

B. PROBLEMS WITH THE SEPARATE AFFILIATE STRUCTURE

THE UTAH ASSOCIATION OF REALTORS® DOES NOT AGREE WITH THOSE WHO ARGUE THAT THE SEPARATE AFFILIATE STRUCTURE ALLEVIATES ANTI-COMPETITIVE AND SAFETY AND SOUNDNESS CONCERNS. ALTHOUGH LEGAL SEPARATION OF PARTS OF THE HOLDING COMPANY MAY BE DESIREABLE TO ASSIST APPROPRIATE FUNCTIONAL REGULATION AND TO HELP CONTAIN THE ELEMENTS OF RISK, AND CONFLICTS OF INTEREST, IT CANNOT PREVENT THEM! THE NATURAL TENDENCY WILL BE TOWARD THE JOINT OFFERING OF A VARIETY OF PRODUCTS LINKED TOGETHER IN A SIGNIFICANT WAY. THE COMBINATION OF BANKING AND REAL ESTATE BROKERAGE IN ONE HOLDING COMPANY MAKES IT MORE LIKELY THAT THESE PRODUCTS WILL BE PURCHASED IN THE SAME PLACE, AND INDUCEMENTS TO PURCHASE ONE SERVICE PACKAGED WITH ANOTHER OFFERED AT AN ENTICING PRICE ARE NATURAL. THERE CAN BE NO DOUBT THAT OPPORTUNITIES FOR TYING, WHETHER BLATANT OR SUBTLE, WILL CONTINUE TO EXIST IF DEPOSITORY INSTITUTIONS ARE PERMITTED TO OFFER REAL ESTATE BROKERAGE AND OTHER SERVICES TOGETHER WITH CONVENTIONAL BANKING PRODUCTS.

III. ABUSES BY DEPOSITORY INSTITUTIONS

THE POTENTIAL FOR ABUSE IS NOT LIMITED TO OUTRIGHT OWNERSHIP. THE NATIONAL ASSOCIATION OF REALTORS® HAS BEEN WRITING THE FEDERAL HOME LOAN BANK BOARD ABOUT A FEDERAL SAVINGS AND LOAN IN LINCOLN, NEBRASKA THAT, WITHOUT SEEKING PRIOR FHLBB APPROVAL, ENTERED INTO A CONTRACTUAL ARRANGEMENT WITH A REAL ESTATE BROKERAGE FIRM. I HAVE ATTACHED COPIES OF NEBRASKA NEWSPAPER ADVERTISEMENTS THAT WILL NO DOUBT LEAVE CONSUMERS IN NEBRASKA WITH THE DISTINCT IMPRESSION THAT FIRST FEDERAL SAVINGS AND LOAN LINCOLN HAS ENTERED THE THIRD PARTY BROKERAGE BUSINESS. FURTHER, THESE ADS CLEARLY IMPLY THAT PREFERENTIAL LENDING RATES ARE AVAILABLE FOR CONSUMERS DOING BUSINESS WITH THEIR REALTOR® AFFILIATE IF THE CONSUMER IS INTERESTED IN A PACKAGE DEAL. LET US NOT FORGET THAT FIRST FEDERAL WAS ABLE TO ACQUIRE THE FUNDS THAT WILL BE USED TO FINANCE SALES OF THE REALTOR® AFFILIATE THROUGH THE USE OF ITS FEDERAL SAVINGS & LOAN INSURANCE CORPORATION INSURANCE STICKER. THAT IS, DEPOSITORS CHOSE TO INVEST THEIR FUNDS WITH AN ENTITY THAT PROVIDES FEDERAL DEPOSIT INSURANCE. I WOULD ALSO LIKE TO PROVIDE SOME CASES SUPPLIED TO US BY THE IOWA ASSOCIATION OF REALTORS®. IOWA'S STATE INSTITUTIONS HAVE BEEN ABLE TO BROKER REAL ESTATE FOR YEARS, AND THESE PROBLEMS HAVE ARISEN:

** A BROKER IN A WESTERN IOWA METROPOLITAN BOARD MADE SEVERAL VISITS TO SOUTHWEST IOWA TO ASSIST ONE OF HIS SALESPERSONS IN LISTING A PROPERTY. THE CLIENT WANTED TO LIST, BUT INFORMED THE SALESPERSON THAT A BANKER IN THE COMMUNITY WAS ALSO LICENSED, AND THE BANKER HAD INFORMED THE PROSPECTIVE CLIENT THAT FINANCING WOULD NOT BE AVAILABLE IF THEY LISTED WITH SOMEONE OTHER THAN HIM;

** A SALESPERSON WITH A FIRM IN A WESTERN IOWA METROPOLITAN BOARD TOOK A CLIENT INTO A SAVINGS AND LOAN FOR A LOAN APPLICATION. A VICE PRESIDENT OF THE S & L CALLED THE BUYER LATER IN THE DAY AND SAID THAT BEFORE THEY COULD PROCEED ON THAT PARTICULAR HOUSE, THAT THEIR TRUST DEPARTMENT HAD SOME PROPERTIES TO SHOW THEM,

** A WATERLOO REALTOR® HAD A HOUSE LISTED FOR SEVERAL MONTHS. THE SELLERS WERE SEVERAL MONTHS BEHIND IN PAYMENTS AND COULD NOT COME UP WITH THE MONEY. WHILE THE LISTING WAS STILL IN EFFECT, THE S & L WHO HELD THE MORTGAGE CALLED ON THE SELLERS AND SAID THEY WERE GOING TO FORECLOSE. HOWEVER, THEY SAID THAT WOULD GIVE THEM AN ADDITIONAL THREE MONTHS IF THEY WOULD LIST THE PROPERTY WITH THEM. THE LISTING FIRM, NOT WANTING TO PLACE THE SELLERS IN JEOPARDY, RELEASED THEM FROM THE LISTING.

THE CASES FORM IOWA AND NEBRASKA PROVIDE A FOUNDATION FOR OUR OPPOSITION AND WE BELIEVE THEY ARE INDICIATIVE OF THE TYPES OF FUTURE PROBLEMS THAT WILL BE CREATED BY THE ENTRY INTO REAL ESTATE BROKERAGE ACTIVITIES BY FEDERALLY INSURED DEPOSITORY INSTITUTIONS. THE SUPPORTIVE INFORMATION ON THE IOWA AND NEBRASKA ARE HERETO ATTACHED.

LOCAL CONCERNS

IN UTAH THE HOUSING FINANCE AGENCY HAS ISSUED SUB-MARKET INTEREST RATE MORTGAGE FUNDS FOR LOW INCOME BUYERS OF HOMES. THE SUPPLY HAS BEEN SMALLER THAN THE DEMAND. IT IS REPORTED THAT LENDERS UTILIZED A LARGE AMOUNT OF THEIR ALLOCATED COMMITMENTS NEARLY EXCLUSIVELY FOR THEIR OWN, NEW HOME INVENTORY AND FOR THEIR FORECLOSED PROPERTY INVENTORY, AND GAVE PREFERENTIAL TREATMENT TO THEIR OWN SUBSIDIARIES, JOINT VENTURE PARTNERS, EMPLOYERS, AND RELATIVES. IF THIS DEREGULATION

LEGISLATION WERE IMPLEMENTED THE POTENTIAL FOR THE ABOVE REFERENCED ABUSES WOULD BE GREATLY MAGNIFIED.

A LOCAL LARGE FEDERALLY INSURED SAVINGS AND LOAN RECENTLY COMPETED WITH OTHER BUYERS, AND PURCHASED A SERIES OF FORMER SERVICE STATIONS AND HAVE, ONE BY ONE DEVELOPED THEM INTO, OR SOLD THEM FOR, MORE PROFITABLE USES. THEY COMPETED IN THE OPEN MARKET PLACE, USING THE ADVANTAGES OF FEDERALLY BORROWED SUB-MARKET INTEREST RATE FUNDS.

AGAIN, WHEN ECONOMIC RESOURCES AND THE POWER OVER THEM ARE TOO NARROWLY CONCENTRATED, THEN ABUSES UNINTENTIONALY OR OTHERWISE MAY OCCUR MORE EASILY.

IN SUMMARY WE ASK THIS COMMITTEE TO CONSIDER THE LONG RANGE IMPACT ON THE AVAILABILITY OF CREDIT TO INDIVIDUALS AND BUSINESSES OF ALL SIZES AND KINDS IN ALL SECTIONS OF THE COUNTRY--IN THE SMALL TOWNS AND RURAL AREAS AS WELL AS THE FINANCIAL CENTERS OF OUR COUNTRY. THE COMMITTEE SHOULD ALSO CONSIDER THE POTENTIALLY HARMFUL EFFECTS OF PRECIPITOUS DEREGULATION, WHICH WOULD PERMIT SUCH ANTI-COMPETITIVE PRACTICES AS TYING ARRANGEMENTS, CROSS SUBSIDIES, AND UNEVEN TAX TREATMENT. THERE HAVE BEEN TREMENDOUS CHANGES IN THE MARKETPLACE WROUGHT BY NEW TECHNOLOGY AND CONSUMER EXPECTATIONS: HOWEVER, WE URGE YOU TO REMAIN OBJECTIVE AND TO EXERCISE CAUTION IN ANY EFFORTS TO DISMANTLE THE PRESENT SYSTEM THAT HAS SERVED OUR COUNTRY SO WELL FOR ALMOST 50 YEARS.

OUR CURRENT FINANCIAL SYSTEM HAS ABLY MET MANY OF THIS COUNTRY'S NEEDS INCLUDING: THE FOSTERING OF HOME OWNERSHIP AT LEVELS UNMATCHED BY ANY OTHER NATION; THE AVAILABILITY OF CREDIT THROUGHOUT THE COUNTRY THAT HAS MADE SMALL BUSINESSES THE BULWARK OF OUR ECONOMY; AND A SECURE, SOUND FINANCIAL SYSTEM, WHICH HAS REGAINED THE PUBLIC CONFIDENCE LOST AMID THE DISRUPTION OF THE MARKET IN THE 1920's. EVEN DURING RECENT TROUBLED TIMES FOR THE THRIFT INDUSTRY, PUBLIC CONFIDENCE REMAINED FIRM. WE ARE CONCERNED THAT PRESUMED EFFICIENCY AND DEREGULATION FOR THEIR OWN SAKES COULD NEGATE THE HARD-EARNED RESULTS OF OUR EXISTING REGULATORY FRAMEWORK.

WE THANK YOU AGAIN FOR THE OPPORTUNITY OF PROVIDING THIS TESTIMONY AND ASSURE YOU OF OUR WILLINGNESS TO HELP IN ANY WAY POSSIBLE THROUGHOUT YOUR LEGISLATIVE PROCESS.

* * * * * * * * * *

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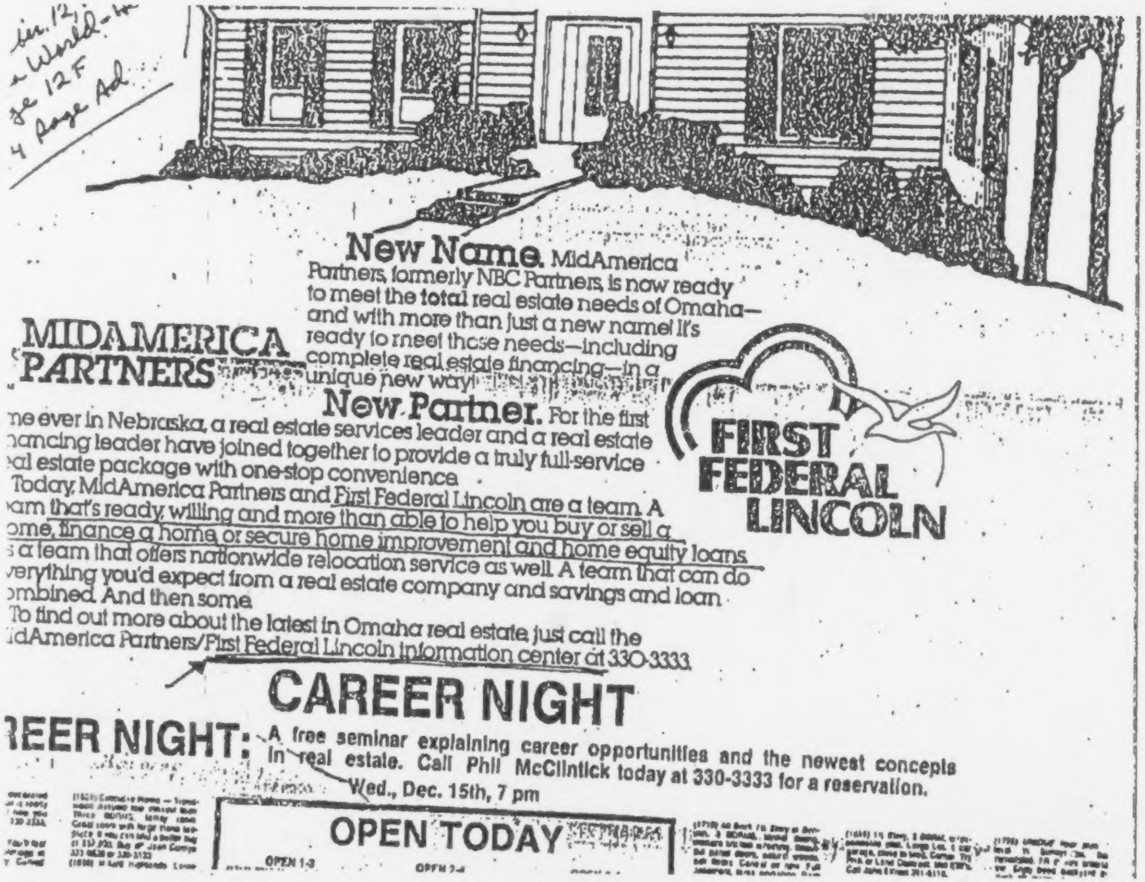
Sincerely,

Charles H. Thorne

CHARLES H. THORNE
PRESIDENT

CHT/tb



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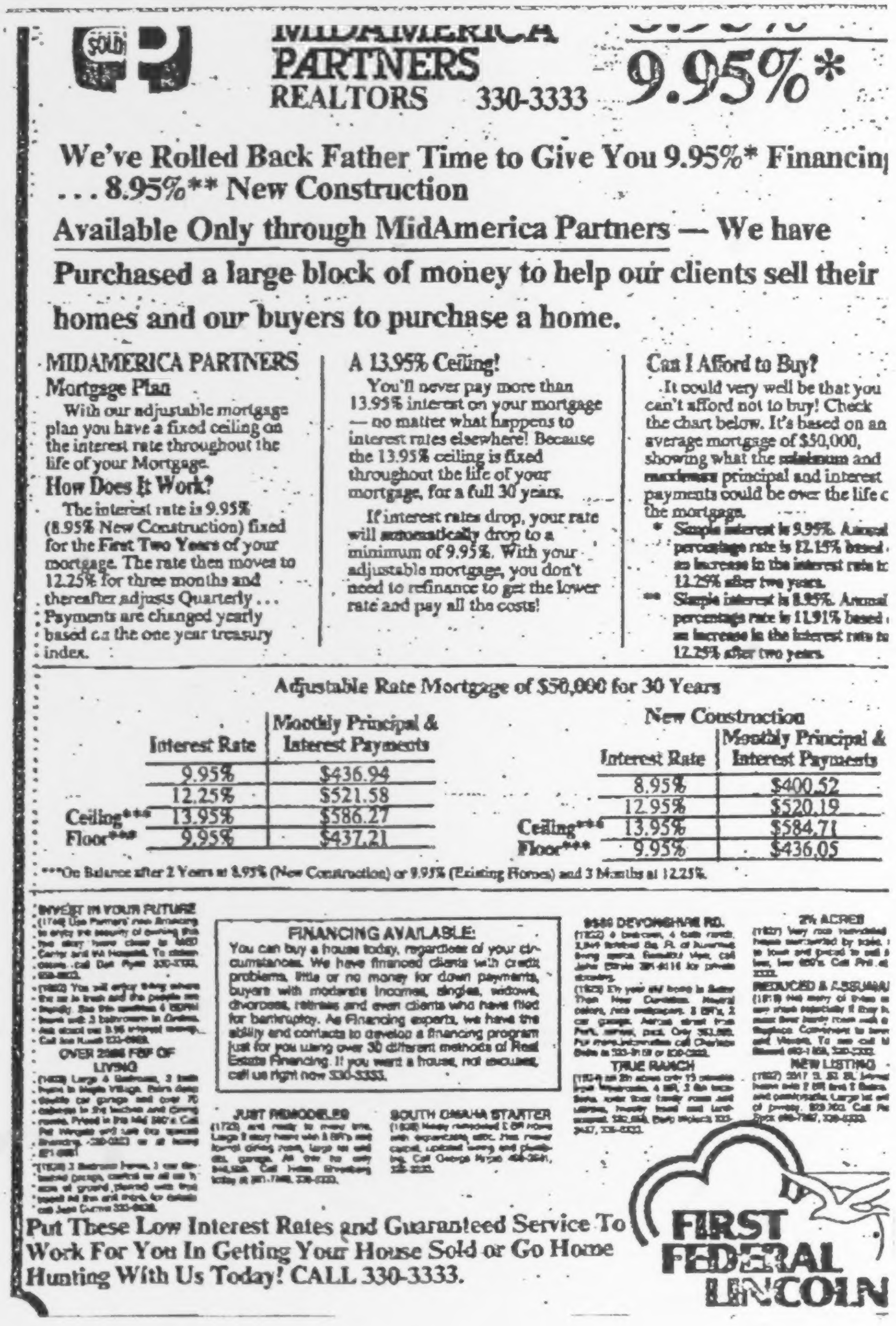

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With our adjustable mortgage plan you have a fixed ceiling on the interest rate throughout the life of your Mortgage.

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The interest rate is 9.95% (8.95% New Construction) fixed for the **First Two Years** of your mortgage. The rate then moves to 12.25% for three months and thereafter adjusts Quarterly . . . Payments are changed yearly based on the one year treasury index.

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You'll never pay more than 13.95% interest on your mortgage — no matter what happens to interest rates elsewhere! Because the 13.95% ceiling is fixed throughout the life of your mortgage, for a full 30 years.

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It could very well be that you can't afford not to buy! Check the chart below. It's based on an average mortgage of $50,000, showing what the **minimum** and **maximum** principal and interest payments could be over the life c the mortgage.

* **Simple interest is 9.95%. Annual percentage rate is 12.15% based an increase in the interest rate t 12.25% after two years.**

** **Simple interest is 8.95%. Annual percentage rate is 11.91% based an increase in the interest rate to 12.25% after two years.**

Adjustable Rate Mortgage of $50,000 for 30 Years

	Interest Rate	Monthly Principal & Interest Payments
	9.95%	$436.94
	12.25%	$521.58
Ceiling***	13.95%	$586.27
Floor***	9.95%	$437.21

New Construction

	Interest Rate	Monthly Principal & Interest Payments
	8.95%	$400.52
	12.95%	$520.19
Ceiling***	13.95%	$584.71
Floor***	9.95%	$436.05

***On Balance after 2 Years at 8.95% (New Construction) or 9.95% (Existing Homes) and 3 Months at 12.25%.

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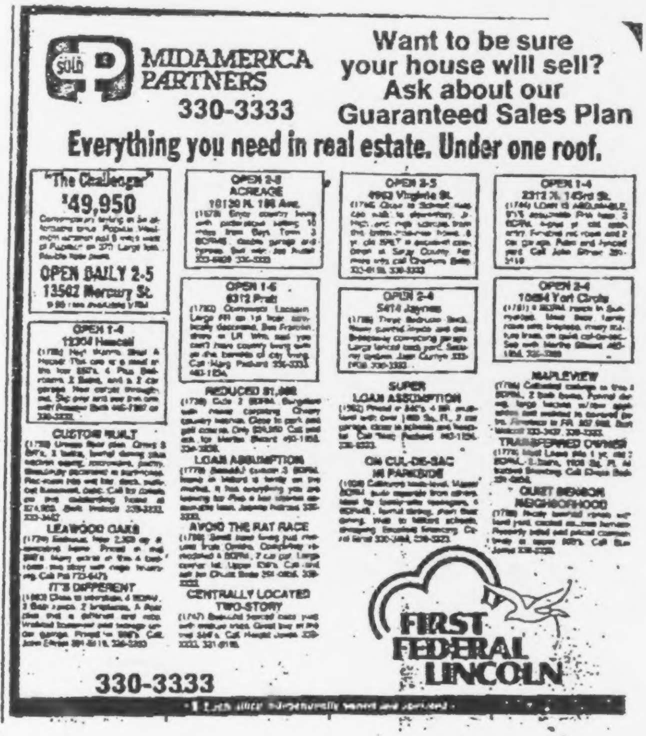

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AVOID THE RAT RACE

IT'S DIFFERENT

CENTRALLY LOCATED
TWO-STORY

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SUPER
LOAN ASSUMPTION

ON CUL-DE-SAC
IN PARKSIDE

OPEN 1-4

OPEN 2-4

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TRANSFERRED OWNER

QUIET BENSON
NEIGHBORHOOD

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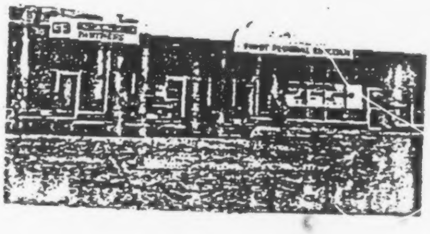

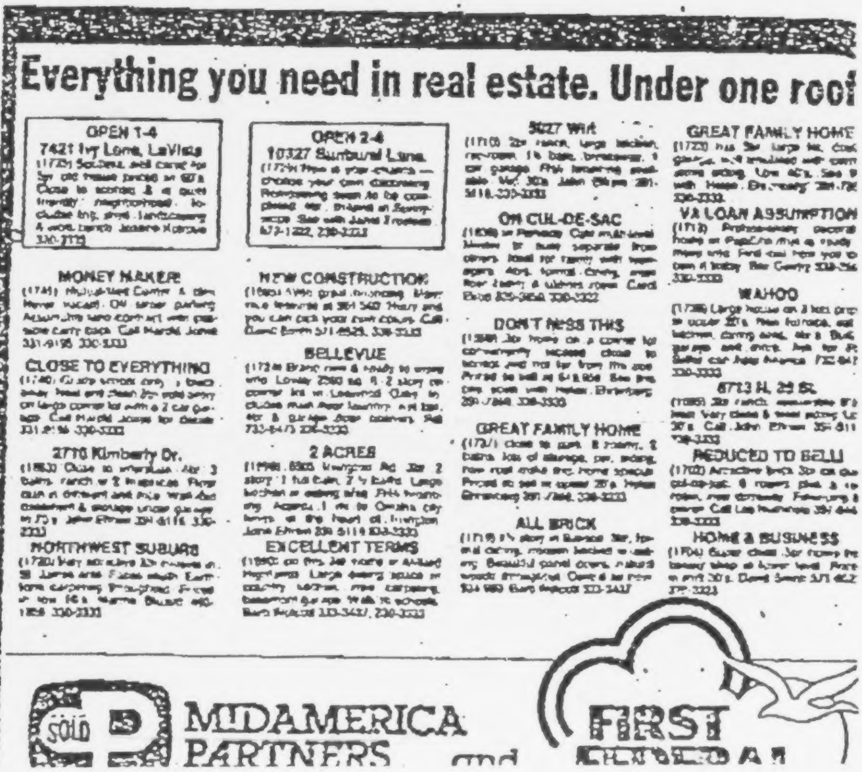

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FIRST

The CHAIRMAN. Thank you very much. We appreciate both of your testimonies. Senator Lautenberg, do you have any questions?

Senator LAUTENBERG. I compliment you on what I think is a very fair balance of witness testimony. We have heard arguments on both sides.

The CHAIRMAN. What do you mean both sides? On every side.

Senator LAUTENBERG. Well, I thought the testimony of the last two individuals was very helpful in terms of my view on what has to be done and in terms of trying to provide balanced and fair legislation.

The CHAIRMAN. Let me thank you for being here. I know it was a special effort for you to come out. I'm glad you were able to be here because I think the hearings have been helpful and your comment earlier about one group being lucid and candid, I thought they all were, all day long. Even Chairman Volcker was lucid and candid today.

Senator LAUTENBERG. Even Secretary Regan.

The CHAIRMAN. I should have told this story earlier as some people were going long. Once when Chairman Volcker appeared before a committee, he had a prepared statement. He has to appear twice a year on monetary supply. His two times a year are mandated by law. He came in and I asked him if he would please summarize his testimony rather than reading his whole statement in the interest of time. And he did; 6 months later when he came back I asked if he would read his statement rather than summarize it so it wouldn't take so much time. He went on and on and on summarizing a written statement that would have taken 20 minutes; about 1½ hours summarizing a 20-minute statement.

But the thing that's important about getting away from Washington, and I'm going to offend some people when I say this, but too often we have the same witnesses representing various groups over and over again, presenting their prepared testimony which is a very broad consensus of their group. I think Senator Lautenberg would agree with me that the testimony we have had today is often much more direct and candid and to the point and comes from people who are in the operating line, not the top of some trade association. I think it's unfortunate that we can't get out of Washington more and hold hearings with—and I must be very careful. I'm thinking of everything I say now. But I'm going to say it any way. Hold hearings with the real people, not Washington establishment.

I think the testimony from all sides, regardless of how people feel about the various issues, has been very good and will be very helpful as we continue the discussions over a period of several weeks, if not months, in additional hearings on these subjects.

I want to let Senator Lautenberg know how I got elected to the Senate. There were a lot of people in Salt Lake City who wanted to get rid of me as mayor. You had the insurance agents here a minute ago and they wanted to get rid of competition and get me out of the insurance business. You had all those people that wanted to get me out of town. That's how you run a successful campaign.

Senator LAUTENBERG. I had a similar experience. Unless I have been misunderstood—and I do disassociate myself from my chairman on this—there are real people in Washington, but especially in New Jersey. There we have real people. And I got elected, Mr. Chairman, because my colleagues who I hired in my company, who were very zealous in my campaign for the Senate office, and I didn't realize until it was all over and saw my parking place gone and my name off my office that they had another motive.

The Chairman. They took your key to the executive washroom.

Mr. Jacobson. He told us how he got elected in the first place, which I don't hardly believe. But he did a tremendous job and got elected again.

The Chairman. My colleague might find it odd that practically everyone on the panels were old friends. But in a State this size, when you go to grade school and high school, you pretty well know everybody. In some of the larger States, that's not possible. So we didn't stack the witness list with friends, and I'm sure you noticed that by the variety of testimony. But we did want to make certain, and I think you know from most of my hearings in Washington, that there are witnesses from all sides, whether I happen to agree with them or not. But I don't think it would have been possible, regardless of who we invited from all the various areas, that I wouldn't know most of them pretty well for a long, long time before any of us were in any of our present positions. A lot of life insurance agents I used to teach in life underwriting training councils years ago.

But I am very pleased with the hearing and all of the witnesses today; the cooperation of the Salt Palace and my colleagues who made the effort to come out here on a cold, snowy day.

Do you have any additional comments you'd like to make?

Senator Lautenberg. No. Thank you.

The Chairman. The hearing is adjourned.

[Whereupon the hearing adjourned at 6 p.m.]

[Additional material submitted for the record follows:]

Statement by Professional Insurance Agents of Utah (PIA of Utah), Concerning the Anticompetitive Impact of Allowing Federally Regulated Depository Institutions To Participate in the General Business of Insurance

PROFESSIONAL INSURANCE AGENTS
OF UTAH
PIA
PROFESSIONAL INSURANCE AGENTS
"We have the answers"

This statement is submitted to the Senate Committee on Banking, Housing and Urban Affairs by the Professional Insurance Agents Association of Utah (PIA) a branch of the National Association of Professional Insurance Agents.

PIA is a national trade association representing more than 40,000 independent property and casualty insurance agents in all 50 States, the District of Columbia, Puerto Rico and the U.S. Virgin Islands.

PIA has long been concerned about the continuing efforts of bank holding companies(BHCs) and other depository institutions to become further involved in the business of insurance. We have closely followed this issue since the 91st Congress and have voiced our opposition to BHCs and the savings and loan industry underwriting and selling insurance to House and Senate Banking Committees whenever an opportunity presented itself.

The general thrust of federal banking legislation since the early days of the Great Depression has involved Congressional efforts to protect the general public and the banking industry itself from unsound banking practices. This policy has been developed in the Glass-Steagall Act of 1933, the Banking Act of 1935, the Bank Holding Company Act of 1956 (BHC Act), the Bank Holding Company Act Amendments of 1970 and the regulatory structure that these laws implemented. The main approach to accomplish the two goals of protecting the public and the soundness of banks has been careful regulation of banking activities, and restrictions upon the commercial activities in which banking organizations may engage. Indeed, the separation of banking and commerce has developed over the years into a sound public policy that has served this nation well.

It is obvious that the competitive pressures now being exerted on regulated depository institutions by the money market funds, financial services conglomerates and, recently, the so-called non-bank banks, to cite a few examples, have been intense. These unregulated financial entities often provide many bank-type services, in addition to totally new creative financial services.

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They function with few or none of the legal restrictions covering regulated institutions. This rapidly changing situation has caused the entire issue of the degree to which banking and commerce should be separated to again come before the Congress, as these oversight hearings have already so amply illustrated.

Federally regulated banking institutions want the current legal restrictions on their economic activities removed so that they can compete, service for service, with operations such as Sears or Merrill Lynch.

PIA is seriously concerned about keeping the general commercial activities of the insurance industry separate from the business of banking, since long before the major changes, some would say "revolution," in financial services began in earnest. National PIA has been engaged since 1968 in a campaign to persuade the Congress that consumer choice and open competition in insurance sales required the enactment of legislation to impose restrictions on the insurance activities of federally chartered BHCs. Over the years, we have joined forces with other trade associations to accomplish this goal. This collective effort finally culminated in the enactment of Title VI of the Garn-St Germain Act of 1982. This act placed clear and concise limitations on the property and casualty and life insurance activities of BHCs and their subsidiaries. Title VI's language and the accompanying Committee Report leave no doubt about Congressional policy.

Title VI is a reasonable approach. It is fair to the BHC's, fair to the insurance industry and above all, fair to the consumer. The major impact of Title VI is consumer protection. Without this provision, a BHC's lending bank need only inform potential borrowers that its parent BHC also has insurance for sale and the tie-in has been made. Anyone seeking credit would logically conclude that purchasing their insurance from the lending BHC may indeed enhance their probabilities of having their loan application approved. Purchasing future insurance needs from the BHC would help them should they later need additional credit. Within this context, getting that loan approved becomes the all-important thing even though the borrower probably could have obtained identical insurance coverage at a lower premium with better follow-up service if he had shopped around in the highly competitive independent insurance market. Title VI precludes such implied tying of general life and property and casualty insurance sales to a BHC's extensions of credit. In this area the consumer maintains his freedom of choice in his insurance purchasing decisions. PIA believes this free and open insurance competition is beneficial to everyone concerned.

On April 6, 1983, Secretary of the Treasury, the Honorable Donald T. Regan, stressed that the Federal Reserve System (Fed) should have the authority to regulate BHCs and their affiliate activities so that all such entities play by the same federal rules. What is important about Secretary Regan's testimony is the idea that the states cannot be allowed to embark on financial services deregulation schemes on a helter-skelter basis because an essential national interest is involved. Some authority has to be in control when a federally-chartered BHC is involved and that authority must be the Fed. PIA supports this proposition.

On April 26, 1983, the Chairman of the Board Governors of the Federal Reserve System, the Honorable Paul A. Volker questioned the merits of allowing BHCs to sell insurance because his experience showed that when one part of a BHC gets into financial trouble, the other part also tends to get into trouble. He did not believe that setting up a subsidiary can really insulate one from the other. PIA believes that Chairman Volker is most perceptive. We can only add to his observations by pointing out that insurance, by its very nature is a highly technical and risky commercial venture, subject to severe fluctuating profit and loss underwriting cycles. Currently, the insurance industry is still experiencing the bottom side of an unusually prolonged underwriting loss cycle. We do not believe that the potential soundness of the banks in a holding company should be jeopardized by speculative investment in the vagaries of the insurance market. This is especially true, in light of recent bank failures.

We sincerely thank the Committee for providing us with this opportunity to present the positions of the National and State Association of Professional Insurance Agents on the structure of the financial services industry.

Richard Q. Perry

RICHARD Q. PERRY, PRESIDENT
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